TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1927

No. 201

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION OF THE COMMONWEALTH OF MASSACHUSETTS, PETITIONER,

vs.

GEORGE I. ROCKWOOD

No. 202

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION OF THE COMMONWEALTH OF MASSACHUSETTS, PETITIONER,

vs.

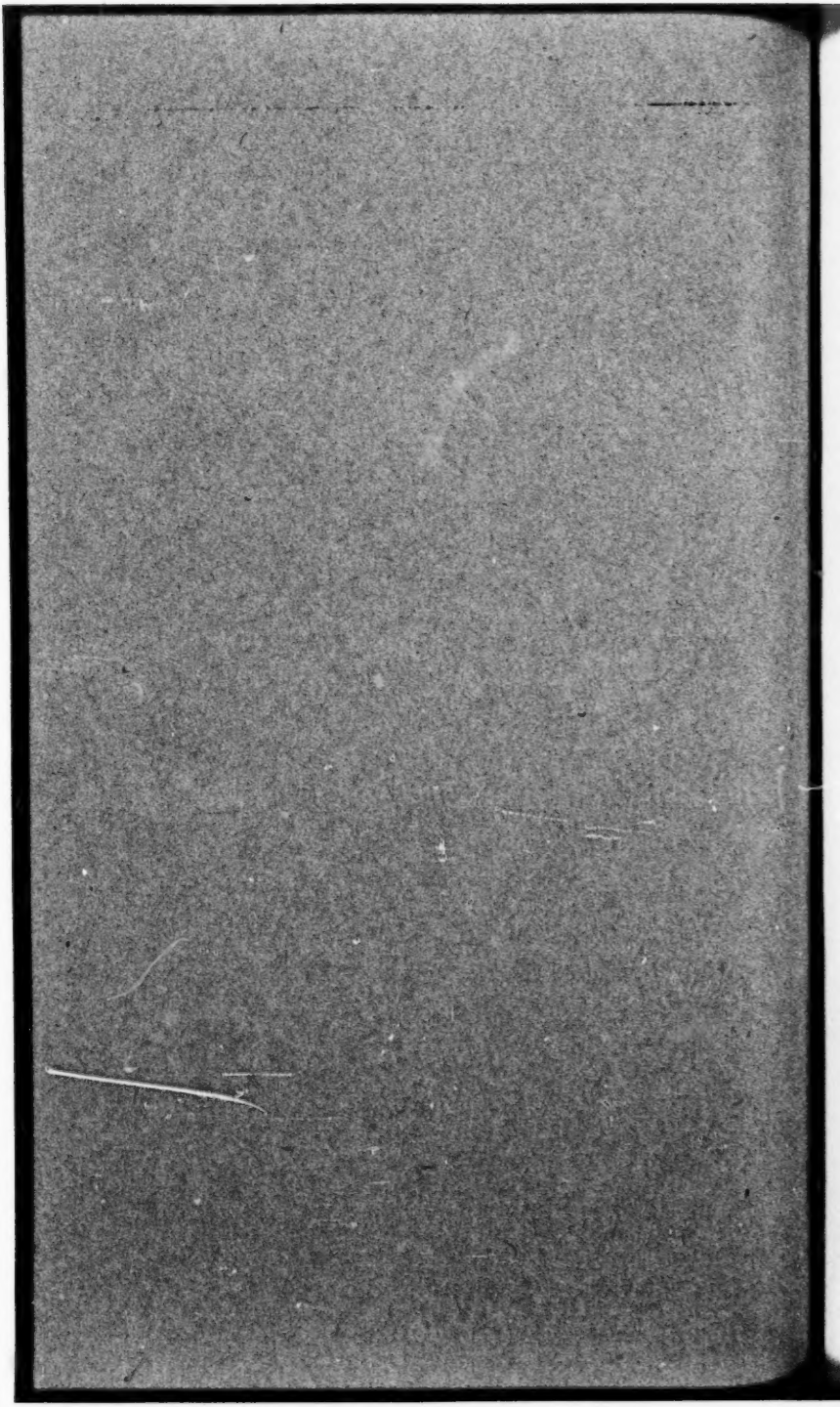
GEORGE I. ROCKWOOD

ON WRITS OF CERTIORARI TO THE SUPERIOR COURT FOR THE COUNTY OF WORCESTER, STATE OF MASSACHUSETTS

PETITION FOR CERTIORARI FILED MARCH 24, 1927

CERTIORARI GRANTED APRIL 25, 1927

(32,560, 32,561)



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ON PETITION FOR WRITS OF CERTIORARI TO THE SUPERIOR COURT OF THE STATE OF MASSACHUSETTS FOR THE COUNTY OF WORCESTER

INDEX

	Original	Print
Record from superior court of Worcester County.....	1	1
Bill of exceptions and order allowing same, cause No. 27819	1	1
Bill of complaint and order to notify defendant.....	2	3
Answer	5	7

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., MARCH 15, 1927

	Original	Print
Report of commissioner	5	7
Stipulation re settlement of case	10	14
Bill of exceptions and order allowing same, cause No. 27820	11	15
Bill of complaint and order to notify defendant	12	17
Answer	15	20
Report of commissioner	15	21
Findings and rulings	20	28
Exhibit "B"—Schedule of business income, 1921	24	33
Exhibit "A"—Analysis of account of George I. Rockwood on books of Rockwood Sprinkler Co	25	33
Exhibit "C"—Schedule of business income, 1922	26	34
Orders overruling exceptions, supreme judicial court	27	35
Opinion, Carroll, J., supreme judicial court	29	36
Judgments	32	39
Motion for stay of execution, etc	34	40
Docket entries	35	41
Clerk's certificate (omitted in printing)	37	
Judge's certificate to clerk (omitted in printing)	38	
Order allowing certiorari		44

[fol. 1] COMMONWEALTH OF MASSACHUSETTS:

IN SUPERIOR COURT OF WORCESTER COUNTY

No. 27819

GEORGE I. ROCKWOOD

vs.

HENRY F. LONG, Commissioner of Corporations and Taxation

BILL OF EXCEPTIONS AND ORDER ALLOWING SAME—Filed November 11, 1925

This is a complaint and appeal under G. L., c. 62, § 47, from the refusal of the defendant to abate an additional income tax for the year 1922 on income received during the year 1921. The complaint and defendant's answer thereto are hereby made a part of this bill of exceptions. The case was referred to a commissioner to hear the parties and report the facts. The commissioner's report is hereby made a part of this bill of exceptions. The case was then heard by Mr. Justice McLaughlin on the commissioner's report and upon certain documents, copies of which are hereto attached marked Exhibits "A" and "B." Thereafter the court made findings and rulings as shown by a memorandum thereof, which is hereby made a part of this bill of exceptions.

At the hearing before the court the defendant duly presented the following requests for rulings:

"1. Income from royalties received for the use of patents issued by the United States to the taxpayer upon inventions made by him is taxable as business income under G. L., c. 62, § 5(b), as amended.

2. Income from royalties received by the complainant from the Rockwood Sprinkler Company, upon the facts reported by the commissioner, was properly assessed to the complainant by the Commissioner of Corporations and Tax-

ation under G. L., c. 62, § 37, as amended, as business income taxable under G. L., c. 62, § 5(b), as amended.

3. Income credited to the taxpayer upon an open or running account subject to be drawn by him at any time is income received by him under G. L., c. 62, § 5, as amended, although such income is not computed upon a basis other than actual cash receipts.

4. Income from royalties received by the complainant from the Rockwood Sprinkler Company was received by him, upon the facts reported by the commissioner, when it was actually credited to his account upon the books of the company.

5. An allowance for depreciation in the value of patents of the United States secured by the taxpayer upon inventions made by him, based upon the actual cost of securing such patents, may be a reasonable allowance under G. L., c. 62, § 6(b), as amended, although the value at the beginning of the year is greater than the cost.

6. The allowance by the Commissioner of Corporations and Taxation for depreciation in the value of the patents [fol. 2] referred to in the complaint, upon the facts reported by the commissioner, on the basis of the actual cost of securing such patents, was a reasonable allowance under G. L., c. 62, § 6(b), as amended."

The defendant seasonably excepted to the rulings of the court and his failure to rule by filing in the clerk's office the following written statements:

"Exceptions to Rulings

The defendant within three days after the receipt of notice from the clerk of the rulings and decision of the court in the above-entitled case hereby takes the following exceptions thereto.

1. The defendant excepts to the ruling on the findings of the Commissioner that in this case the income from the royalties was not income from business and was not taxable.

2. The defendant excepts to the decision hereinabove referred to."

"Defendant's Exception to Failure to Rule

The defendant within three days after the receipt of notice from the clerk of the rulings and decision of the court in the above-entitled case hereby excepts to the failure of the court in his decision to give rulings numbered 1, 2, 3, 4, 5 and 6, requested by the defendant."

Wherefore, being aggrieved by the rulings and decision of the court as hereinabove stated, the defendant brings this his bill of exceptions and prays that the same may be allowed.

Henry F. Long, Commissioner of Corporations and Taxation, by Alexander Lincoln, Assistant Attorney General.

Exceptions allowed. John D. McLaughlin, J. S. C.

Filed Nov. 11, 1925.

(For Exhibits "A" and "B" see copies attached to this record.)

In Superior Court of Worcester County

Bill of Complaint and Order to Notify Defendant—
Filed February 28, 1924

(Filed under Section 47, Chapter 62, of the General Laws as amended by Chapter 113, General Acts of 1921 as further amended by Chapter 287, General Acts 1923.)

Respectfully George I. Rockwood brings and files this complaint against Henry F. Long, as he is duly constituted Commissioner of Corporations and Taxation of the Commonwealth of Massachusetts, and as grounds for said complaint, alleges as follows:

[fol. 3] One. That he was on and prior to January 1, 1921 and has been since that date, and still is a citizen of said Commonwealth and resident of Worcester, in the County of Worcester and said Commonwealth, maintaining also at said Worcester his principal place of business.

Two. That pursuant to the provisions of Chapter 62 of the General Laws and acts amendatory thereof and in addition thereto, complainant on or before March 1, 1922 did duly file an income tax return with the Income Tax Division of respondent's department, fully making known therein items of income received by him during the calendar year 1921 and subsequent thereto the respondent did assess and the complainant did pay an income tax for the year 1922 based upon said return.

Three. That during the year 1923 the respondent Commissioner acting under and pursuant to the provisions of Section 37 of said Chapter 62, and acts amendatory thereof and in addition thereto, did claim to find by verification of said return that the income of the complainant for the year subject to taxation under said Chapter 62 or some portion thereof had not been assessed, and did thereupon and thereafter assess the same; at the same time similarly acting under said section in connection with an additional 1923 tax based upon 1922 income.

Four. Acting as aforesaid, and through and by the Income Tax Division of his department, the respondent Commissioner did by tax bill dated December 1, 1923 make demand upon the complainant for payment of $1,605 being $1,500 assessed the said complainant as an additional income tax for the year 1922 plus interest of $105 at the rate of 6% per annum from October 1, 1922, including in said assessment the amount of $1,500 as a tax upon compensation for services and U. S. patent royalties as additional taxable business income received during said year 1921 and disallowing all claims for depreciation or depletion of said patent values.

Five. That complainant duly paid said assessed tax and interest, as demanded, under compulsion and protest and did duly file an abatement claim with said respondent Commissioner and did set forth in said abatement claim and did urge at a hearing thereon, the contentions in substance as hereinafter set forth in this complaint.

Six. That said abatement claim and contentions therein were rejected by said respondent Commissioner and regis-

tered mail notice thereof given complainant, said notice being received by complainant on February 19, 1924.

Seven. That complainant contends:

(a) the assessment and demand for said tax of $1,500 is illegal and excessive.

(b) the assessment and demand for said interest of $105 is illegal.

(c) the tax originally and previously paid is excessive and the excess or over-payment to be found on said verification should be deducted against any additional tax found due for the subsequent year 1923, and as grounds for said contentions alleges as follows:

(a) the patents granted complainant by the United States Government prior to year 1916 and the royalties therefrom received by complainant in year 1921 are not taxable under said Chapter 62 (as amended), and there was error to include said royalties as subject to tax; and

[fol. 4] (b) the ownership of said patents and receipt of royalties in year 1921 under the facts did not constitute income derived "from professions, employments, trade or business" as defined under said Chapter 62 (as amended) and there was error to include royalties as subject to tax; and

(c) if said royalties are taxable as such income so derived, said Chapter permits of a reasonable allowance in year 1921 for depreciation or depletion of the patent values and what is reasonable is a question of fact based upon the patent values subsequent to January 1, 1916 and there was error in computing the 1921 allowance to complainant solely on the cost value prior to January 1, 1916 and thus failing to grant any allowance; and

(d) under the so-called cash receipt basis employed by complainant in his return several items of royalties and compensation for services are overstated and there was error in not excluding same on verification; and

(e) the interest item of $105 was demanded pursuant to the provisions of Chapter 143 of the Acts of 1922, and said Chapter does not apply on verification of tax returns due and filed prior to its approval and effective dates.

Eight. That your complainant brings this action under Section 47 of Chapter 62 of the General Laws, as amended by Chapter 113, General Acts of 1921 and as further amended by Chapter 287, General Acts of 1923.

Wherefore the complainant prays judgment for the sum of $1,605 any part thereof, or such greater sum as may be legally refundable.

George I. Rockwood, by Smith, Gage & Dresser, His Attorneys.

Commonwealth of Massachusetts,
Worcester, ss:

Superior Court

February 28th, A. D. 1924.

On the Complaint aforesaid, It is Ordered, That the Petitioner notify the said Henry F. Long, Commissioner of Corporations and Taxation for the Commonwealth of Massachusetts, to appear at this Court, at Worcester, in said County, on Thursday, the twentieth day of March current, by serving him with an attested copy of said Complaint, and this Order, fourteen days at least before said twentieth day of March, that he may, then and there, show cause why the prayer of said Complaint should not be granted.

Attest:

Frank L. Dean, Clerk.

Filed February 28th, 1924, and notice ordered to issue, ret. March 20th, 1924, service to be made 14 days before [fol. 5] ret. day. (Walsh, J.)

Notice issued as ordered. Attest: Frank L. Dean, Clerk.

May 15, 1924.—Edwin G. Norman, Esq. apptd. Commissioner—report to be filed on or before Sept. 1, 1924.

IN SUPERIOR COURT OF WORCESTER COUNTY

ANSWER—Filed April 10, 1924

The defendant for answer to the complaint herein says as follows:

1. He admits the allegations of the complaint except as hereinafter stated.

2. He denies that the income tax return filed by the complainant fully disclosed the income received by the complainant during the calendar year 1921, as alleged in paragraph 2 of the complaint.

3. As to paragraph 3 the defendant says that the additional tax assessed by him was based on his finding from the verification of said return or otherwise that a portion of the complainant's income subject to taxation for the year 1921 had not been assessed.

4. The defendant denies that the complainant's contentions and grounds for contentions stated in paragraph 7 are true, and says that the additional tax assessed was in every respect legal and valid.

Henry F. Long, Commissioner of Corporations and Taxation, by Alexander Lincoln, Assistant Attorney General.

IN SUPERIOR COURT OF WORCESTER COUNTY

[Title omitted]

REPORT OF COMMISSIONER—Filed June 1, 1925

Pursuant to an order of Court referring the above entitled case to me as Commissioner to hear the parties and their evidence, I have heard the parties and their evidence [fol. 6] and report my findings with such facts and questions of law as have been requested by either party as follows:

1. The petitioner was a citizen of this Commonwealth and resident of the City of Worcester on January 1, 1921

and for many years prior thereto, and has so continued to the present time; maintaining also then and during said period of time at said Worcester his principal place of business.

2. On or before March 1, 1922 the petitioner duly filed an income tax return with the income tax division of the Department of Corporations and Taxation of this Commonwealth, purporting to set forth all of the income received by the petitioner during the calendar year 1921. Said tax return was made on an actual cash basis, pursuant to Chapter 62 of the General Laws and acts amendatory thereof and in addition thereto.

3. Upon the basis of said tax return the Commonwealth assessed and the petitioner seasonably paid an income tax for the year 1922.

4. During the year 1923 the Respondent Commissioner, by said Income Tax Division, verified the return submitted by the petitioner above mentioned and claimed to find that the income of the petitioner for the tax year 1922 or some portion of the same had not been assessed. The Commissioner thereupon made an additional assessment. At the same time the Commissioner made an additional assessment for 1923, upon the petitioner, based upon income received by the petitioner during the year 1922 under a claim that the petitioner's income for 1922 or some portion of the same had not been assessed. The validity of this assessment is questioned in another action similar to this action, in this Court. The verification and assessments for these two years were made under the provisions of section 37 of chapter 62 of General Laws as amended.

5. In accordance with the former assessments mentioned in the next preceding paragraph the Respondent Commissioner by a tax bill dated December 1, 1923 made demand upon the petitioner for payment of the sum of $1,605. Of this amount demanded, the sum of $1,500 was assessed as the additional income tax based upon the extra assessment upon income claimed to have been received by the petitioner during the year 1921 and omitted from his return for that period. The remainder, $105, was interest on said

assessment at the rate of 6% per annum from October 1, 1922. The petitioner duly paid said assessed tax and interest as determined under compulsion and protest, and duly filed an abatement claim with said Respondent Commissioner, and at a hearing upon said abatement claim urged the contentions in support of his claim as set forth in the complaint in this proceeding. The said abatement claim and contentions were rejected by the Respondent Commissioner and registered mail notice thereof was given the petitioner, said notice being received by the petitioner on February 19, 1924.

6. In the return of the petitioner of income received by him for the year 1921 he included an item on account of royalties of $50,000; two items of salaries received from the two corporations herein mentioned totalling $46,000; the sum of $55 as director's fee; and an item of $24,917.20 returned as "additional compensation 1920 credited from Worcester Company." The two items of salaries covered amounts received by the petitioner at regular intervals during 1921. The payments included on account of royalties consisted of the sum of $20,000 actually paid to the petitioner on June 21, 1921; and the sum of $30,000 actually [fol. 7] paid to the petitioner on October 1, 1921. The item of $24,917.20 was credited to the petitioner on the books of the Worcester Company in the month of January, 1921 as of December 31, 1920. These two payments totalling $50,000 were charged by the Assistant Treasurer of the company to the petitioner as described in paragraph 13, and applied in part payment of certain royalty credits as of December 31, 1919 to the extent of $29,823.52 and of the 1920 additional compensation credit to the extent of $20,176.48. It is conceded by the defendant that the sum of $20,176.48 was by error twice included in the return and that the gross income should be reduced by deducting this amount, this error being discovered upon the verification above mentioned. In the same return the petitioner claimed as a deduction from his gross income depreciation and depletion on patents amounting to the sum of $100,000.

7. Upon verification of the petitioner's tax return of income received by him for the year 1921 the Income Tax

Division of the Department of Taxation disallowed the depreciation of $100,000 claimed. The disallowance of the depreciation claimed is objected to by the petitioner. The disallowance of the depreciation thus claimed; and the addition of interest on the tax assessed are objected to by the petitioner and are the principal ground for the present action to recover payment of the assessment resulting from these changes.

8. As above stated the sum of $105 was added to the assessment, being interest on the extra assessment from October 1, 1922. It is not disputed that the foundation for this claim of interest rests upon the provisions of chapter 143 of the Acts of 1922, approved May 10, 1922.

9. Upon the date of the complaint and from 1906 previous the petitioner has been the President, Treasurer and principal stockholder of the Rockwood Sprinkler Company, a corporation located in said City of Worcester. From time to time prior to 1916 the petitioner has invented certain sprinkler systems protected by patents, for the manufacture and sale of which systems said corporation was organized. These patents have been put to the use of the corporation by consent of the petitioner. In return for this use the corporation has paid to the petitioner certain sums as royalties. The royalty payments have been made at irregular intervals whenever requested by the petitioner. The rate of payments has always been based upon the units produced under the patent rights, but the rate per unit has not been uniform, being fixed from time to time by the petitioner. The petitioner also received from this corporation a weekly salary of a fixed amount paid to him each week. The petitioner's returns in the form of royalties above mentioned were paid to him in large amounts, there being only two payments made to him in the year 1921 and no payment in the year 1922.

10. In 1917 and since, there has been in existence another corporation called the Rockwood Sprinkler Company of Illinois. This company was affiliated with the first mentioned corporation, its function being to purchase the manufactured products of the Rockwood Sprinkler Company first mentioned and sell them in the parts of the country remote

from its neighborhood. The petitioner has, from its inception, been the President and Treasurer of the Illinois Company also, but no direct use has been made by the Illinois Company of the petitioner's patents and no sums as royalties or otherwise have been received by, or credited to, [fol. 8] the petitioner, from the Illinois Company for the use of the petitioner's patents.

11. In the matter of crediting the petitioner's royalties the Rockwood Sprinkler Company adopted and consistently used the following method. As soon as convenient in the settlement of accounts after the end of each calendar year the amount of royalties due to the petitioner from the articles sold by the company under the petitioner's patents during the previous calendar year, was computed by the assistant treasurer who had charge of the company's books of account. These computations were then delivered to the company's accountant and then with his approval were placed to the credit of the petitioner upon the books of the company as of the year preceding. This process was done before the closing of the company's books of account for the previous year.

12. As stated above the payment of royalties to the petitioner was made to him when requested and in such amounts as were requested. The petitioner was willing for the company to have the use of the money due him as royalties, as it saved the company from the necessity of borrowing money. There was no evidence introduced as to whether or not the company was in sufficient funds to pay the petitioner the amounts credited to him upon the dates they were so credited; and it appeared that before the assessment complained of the income tax division had made no investigation as to the financial condition of the company. It was admitted, however, that the company was at all times solvent and its assets at all times sufficient to pay the amounts credited to the petitioner.

13. As to the application of payments made to the petitioner on account of royalties, whenever a payment on account was requested by the petitioner, it was the custom of the assistant treasurer to place such payments against the oldest unpaid credits of the petitioner. This method

was adopted by the assistant treasurer as a mode of convenience and was without official sanction from the Board of Directors or other managing officers of the company.

14. As above mentioned in paragraph 7 the Commissioner disallowed a claim for a deduction on the petitioner's return for income received in 1921 on account of the depreciation or depletion on patents. The depreciation was claimed on account of the patents above referred to which were procured on inventions of the petitioner and used by the Rockwood Sprinkler Company. It is the contention of the Commissioner that the item of depreciation if allowed be based upon the original cost of the patents which so far as appears was not in excess of the sum of $2,000. It is admitted by both parties that on January 1, 1916, the patents in the aggregate, taking into consideration the varying length of time remaining for each patent, had increased to a very large amount. The agreement of the parties with relation thereto is as follows:

"It is agreed that, if material, the value of the patents (referred to in the complaint) on January 1, 1916 was six hundred thousand ($600,000) dollars and thereafter on each succeeding year to and including the year 1921 the value was the said sum of six hundred thousand ($600,000) dollars less that multiple of 9.09% of six hundred thousand ($600,000) dollars which corresponds to the number of years intervening between each succeeding year and the said date, January 1, 1916."

[fol. 9] 15. The amounts assessed as above stated upon the petitioner by the respondent have been by virtue of authority claimed under chapter 62 of General Laws and acts in amendment and in addition thereto. By section 38 of this chapter it is provided "The Commissioner may from time to time, make such rules and regulations, not contrary to this chapter, as he deems necessary to carry out its provisions." The Commissioner has accordingly made rules and regulations certain of which, relative to the subject matter of this complaint, are set forth in the following paragraph.

16. The rules and regulations of the Commissioner are as follows:

"1009. Income is considered to be received for the purposes of this act when (1) it is actually paid in cash, by check or other negotiable instrument, of the equivalent of cash; (2) when it is credited by a bank or banking institution; (3) when it is credited upon the books of a broker, banker or agent of the taxpayer; (4) when it is credited upon an open or running account between the parties with other mutual charges; (5) when payment therefor is made in merchandise or other commodities; (6) when payment therefor is made by services rendered."

"6028. Income received in the form of royalties, or in the form of other deferred payments, shall be taxable to the recipient as business income."

"6077. Royalties received by an heir of the original patentee or copyrightee are not taxable as business income."

"7032. One-seventeenth of the actual cost of securing or purchasing patent rights may be claimed as an annual allowance for the depletion thereof."

17. At the time of the acts complained of it was an established practice of the Income Tax Division of the Department of Corporations and Taxation of this Commonwealth, to regard as received, income credited to the account of a taxpayer when it could be drawn against; and where nothing appeared to the contrary to regard assets available to pay the amounts credited, and the credit a constructive receipt. If the fact of the amount to be credited could not be determined until after the closing period the division regarded the payment as made when the entry of the credit was actually made. It was also the practice to include royalties received as business income; and in the allowance for depreciation on patents yielding royalties, to determine the depreciation as one seventeenth of the cost of the patents, whether the income was received by one who purchased the patents or paid the original expense of acquiring them.

18. It is believed that the question of whether or not royalties as above described constituted taxable income in this Commonwealth; and whether, under the circumstances above, the royalties credited to the petitioner, if taxable income, were properly considered income when actually cred-

ited to the petitioner; and further if the interest assessed upon the petitioner as above described, was properly assessed under the provisions of chapter 143 of the Acts of 1922; and further if the depreciation on patents claimed by the petitioner was properly disallowed by the Commissioner; and, further, if on the aforesaid verification, the proper abatements were made; are all, in connection with [fol. 10] the facts of the case, questions of law to be decided by the court. If, however, it should appear that the abatement as requested by the petitioner or any part, is granted, the sum abated shall be repaid to the complainant by the State Treasurer with interest at the rate of 6% per annum from December 14, 1923 to the date of repayment.

19. At the request of the respondent I am attaching hereto Exhibit B, a schedule of the business income of the petitioner for the year 1921, with changes by the Commissioner.

Respectfully submitted.

Edwin G. Norman.

In Superior Court of Worcester County

Stipulation re Settlement of Case

It is hereby stipulated in the above cause that if the defendant's exceptions are overruled the amount to be repaid to the complainant is $799.04, with interest at the rate of six per cent from December 14, 1923, and costs.

Gage, Hamilton, June & White, Attorneys for Complainant. Alexander Lincoln, Assistant Attorney General.

Filed Dec. 2, 1925.

(Findings and rulings in both cases at end of following case, No. 27820.)

[fol. 11] In Superior Court of Worcester County

No. 27820

George I. Rockwood

vs.

Henry F. Long, Commissioner of Corporations and Taxation

Bill of Exceptions and Order Allowing Same—Filed November 11, 1925

This is a complaint and appeal under G. L., c. 62, § 47, from the refusal of the defendant to abate an additional income tax for the year 1923 on income received during the year 1922. The complaint and defendant's answer thereto are hereby made a part of this bill of exceptions. The case was referred to a commissioner to hear the parties and report the facts. The Commissioner's report is hereby made a part of this bill of exceptions. The case was then heard by Mr. Justice McLaughlin on the commissioner's report and upon certain documents, copies of which are hereto attached marked Exhibits "A" and "C." Thereafter the court made findings and rulings as shown by a memorandum thereof, which is hereby made a part of this bill of exceptions.

At the hearing before the court the defendant duly presented the following requests for rulings:

"1. Income from royalties received for the use of patents issued by the United States to the taxpayer upon inventions made by him is taxable as business income under G. L., c. 62, § 5 (b), as amended.

2. Income from royalties received by the complainant from the Rockwood Sprinkler Company, upon the facts reported by the commissioner, was properly assessed to the complainant by the Commissioner of Corporations and Taxation under G. L., c. 62, § 37, as amended, as business income taxable under G. L., c. 62, § 5 (b), as amended.

3. Income credited to the taxpayer upon an open or running account subject to be drawn by him at any time is in-

come received by him under G. L., c. 62, § 5, as amended, although such income is not computed upon a basis other than actual cash receipts.

4. Income from royalties received by the complainant from the Rockwood Sprinkler Company was received by him, upon the facts reported by the commissioner, when it was actually credited to his account upon the books of the company.

5. An allowance for depreciation in the value of patents of the United States secured by the taxpayer upon inventions made by him, based upon the actual cost of securing such patents, may be a reasonable allowance under G. L., c. 62, § 6 (b), as amended, although the value at the beginning of the year is greater than the cost.

6. The allowance by the Commissioner of Corporations and Taxation for depreciation in the value of the patents re- [fol. 12] ferred to in the complaint, upon the facts reported by the commissioner, on the basis of the actual cost of securing such patents, was a reasonable allowance under G. L., c. 62, § 6 (b), as amended."

The defendant seasonably excepted to the rulings of the court and his failure to rule by filing in the clerk's office the following written statements:

"Exceptions to Rulings

The defendant within three days after the receipt of notice from the clerk of the rulings and decision of the court in the above-entitled case hereby takes the following exceptions thereto.

1. The defendant excepts to the ruling that under the circumstances reported by the Commissioner the royalties were not income from business and therefore were not assessable.

2. The defendant excepts to the ruling that under the circumstances reported by the Commissioner the royalties were not income received within the meaning of the income tax law.

3. The defendants excepts to the decision hereinabove referred to."

"Defendant's Exception to Failure to Rule

The defendant within three days after the receipt of notices from the clerk of the rulings and decision of the court in the above-entitled case hereby excepts to the failure of the court in his decision to give rulings numbered 1, 2, 3, 4, 5 and 6, requested by the defendant."

Wherefore, being aggrieved by the rulings and decision of the court as hereinabove stated, the defendant brings this his bill of exceptions and prays that the same may be allowed.

Henry F. Long, Commissioner of Corporations and Taxation, by Alexander Lincoln, Assistant Attorney General.

Exceptions allowed. John D. McLaughlin, J. S. C.

Filed Nov. 11, 1925.

(For Exhibits "A" and "C" see copies attached to this record.)

In Superior Court of Worcester County

Bill of Complaint and Order to Notify Defendant—Filed February 28, 1924

(Filed under Section 47, Chapter 62 of the General Laws [fol. 13] as amended by Chapter 113, General Acts of 1921 as further amended by Chapter 287, General Acts 1923.)

Respectfully George I. Rockwood brings and files this complaint against Henry F. Long, as he is duly constituted Commissioner of Corporations and Taxation of the Commonwealth of Massachusetts, and as grounds for said complaint, alleges as follows:

One. That he was, on and prior to January 1, 1921, and has been since that date, and still is a citizen of said Commonwealth and resident of Worcester, in the County of Worcester and said Commonwealth, maintaining also at said Worcester his principal place of business.

Two. That pursuant to the provisions of Chapter 62 of the General Laws, and acts amendatory thereof and in addition thereto, complainant on or before March 1, 1923 did duly file an income tax return with the Income Tax Division of respondens't department fully making known therein items of income received by him during the calendar year 1922, and subsequent thereto the respondent did assess and the complainant did pay an income tax for the year 1922 based upon said return.

Three. That during the year 1923 the respondent Commissioner acting under and pursuant to the provisions of Section 37 of said Chapter 62, and acts amendatory thereof and in addition thereto, did claim to find by verification of said return that the income of the complainant for the year subject to taxation under said Chapter 62 or some portion thereof had not been assessed, and did thereupon and thereafter assess the same, at the same time similarly acting under said section in connection with an additional 1922 tax based on 1921 income.

Four. Acting as aforesaid, and through and by the Income Tax Division of his department, the respondent Commissioner did by tax bill dated December 1, 1923 make demand upon the complainant for payment of $1,537.85 being $1,522.62 assessed the said complainant as an additional income tax for the year 1923 plus interest of $15.23 at the rate of 6% per annum from October 1, 1923 including in said assessment the amount of $1,522.62 as a tax upon United States patent royalties as additional taxable business income received during said year 1922 and disallowing all claims for depreciation or depletion of said patent values.

Five. That complainant duly paid said assessed tax and interest, as demanded, under compulsion and protest and did duly file an abatement claim with said respondent Commissioner, and did set forth in said abatement claim and did urge at a hearing thereon, the contentions in substance as hereinafter set forth in this complaint.

Six. That said abatement claim and contentions therein were rejected by said respondent Commissioner and regis-

tered mail notice thereof given complainant, said notice being received by complainant on February 19, 1924.

Seven. That complainant contends:

(a) the assessment and demand for said tax of $1,522.62 is illegal and excessive.

(b) the tax originally and previously paid is excessive and the excess or over-payment to be found on said verifica-
[fol. 14] tion should be deducted against any additional tax found due for the prior year 1922, and as grounds for said contentions alleges as follows:

(a) the patents granted complainant by the United States Government prior to year 1916 and the royalties therefrom received by complainant in year 1922 are not taxable under said Chapter 62 (as amended), and there was error to include said royalties as subject to tax; and

(b) the ownership of said patents and receipt of royalties in year 1922 under the facts did not constitute income derived "from professions, employments, trade or business" as defined under said Chapter 62 (as amended) and there was error to include royalties as subject to tax; and

(c) if said royalties are taxable as such income so derived, said Chapter permits of a reasonable allowance in year 1922 for depreciation or depletion of the patent values and what is reasonable is a question of fact based upon the patent values subsequent to January 1, 1916 and there was error in computing the 1922 allowance to complainant solely on the cost value prior to January 1, 1916 and thus failing to grant any allowance; and

(d) under the so-called cash receipt basis employed by complainant in his return several items of royalties and compensation for services are overstated and there was error in not excluding same on verification;

Eight. That your complainant brings this complaint under Section 47 of Chapter 62 of the General Laws as amended by Chapter 113, General Acts of 1921 and as further amended by Chapter 287, General Acts of 1923.

Wherefore the complainant prays judgment for the sum of $1,522.62, any part thereof, or such greater sum as may be legally refundable.

George I. Rockwood, by Smith, Gage & Dresser, His Attorneys.

COMMONWEALTH OF MASSACHUSETTS,
Worcester, ss:

SUPERIOR COURT

February 28, A. D. 1924.

On the complaint aforesaid, it is ordered, That the petitioner notify the said Henry F. Long, Commissioner of Corporations and Taxation for the Commonwealth of Massachusetts, to appear at this Court, at Worcester, in said County, on Thursday, the twentieth day of March current, by serving him with an attested copy of said Complaint, and this Order, fourteen days at least before said twentieth day of March, that he may, then and there, show cause why the prayer of said Complaint should not be granted.

Attest:

Frank L. Dean, Clerk.

Filed February 28th, 1924, and notice ordered to issue, [fol. 15] ret. March 20th, 1924, service to be made 14 days before ret. day. (Walsh, J.)

Notice issued as ordered. Attest: Frank L. Dean, Clerk.

May 15, 1924, Edwin G. Norman, Esq. appt'd. Commissioner—report to be filed on or before Sept. 1, 1924.

IN SUPERIOR COURT OF WORCESTER COUNTY

ANSWER—Filed April 10, 1924

The defendant for answer to the complaint herein says as follows:

1. He admits the allegations of the complaint except as hereinafter stated.

2. He denies that the income tax return filed by the complainant fully disclosed the income received by the complainant during the calendar year 1922, as alleged in paragraph 2 of the complaint.

3. As to paragraph 3 the defendant says that the additional tax assessed by him was based on his finding from the verification of said return or otherwise that a portion

of the complainant's income subject to taxation for the year 1922 had not been assessed.

4. The defendant denies that the complainant's contentions and grounds for contentions stated in paragraph 7 are true, and says that the additional tax assessed was in every respect legal and valid.

Henry F. Long, Commissioner of Corporations and Taxation, by Alexander Lincoln, Assistant Attorney General.

In Superior Court of Worcester County

No. 27820

[Title omitted]

Report of Commissioner—Filed June 1, 1925

Pursuant to an order of Court referring the above entitled case to me as Commissioner to hear the parties and their evidence, I have heard the parties and their evidence [fol. 16] and report my findings with such facts and questions of law as have been requested by either party as follows:

1. The petitioner was a citizen of this Commonwealth and resident of the City of Worcester on January 1, 1921 and for many years prior thereto, and so continued to the present time, maintaining also then and during said period of time at said Worcester his principal place of business.

2. On or before March 1, 1923 the petitioner duly filed an income tax return with the income tax division of the Department of Corporations and Taxation of this Commonwealth, purporting to set forth all of the income received by the petitioner during the calendar year 1922. Said tax return was made on an actual cash basis, pursuant to Chapter 62 to the General Laws and acts amendatory thereof and in addition thereto.

3. Upon the basis of said tax return the Commonwealth assessed and the petitioner seasonably paid an income tax for the year 1923.

4. During the year 1923 the Respondent Commissioner, by said Income Tax Division, verified the return submitted by the petitioner above mentioned and claimed to find that the income of the petitioner for the tax year 1923 or some portion of the same had not been assessed. The Commissioner thereupon made an additional assessment. At the same time the Commissioner made an additional assessment for 1922, upon the petitioner, based upon income received by the petitioner during the year 1921 under a claim that the petitioner's income for 1921 or some portion of the same had not been assessed. The validity of this assessment is questioned in another action similar to this action, in this Court. The verification and assessments for these two years were made under the provisions of section 37 of chapter 62 of General Laws as amended.

5. In accordance with the former assessments mentioned in the next preceding paragraph the Respondent Commissioner by a tax bill dated December 1, 1923 made demand upon the petitioner for payment of the sum of $1,537.85 Of this amount demanded, the sum of $1,522.22 was assessed as the additional income tax based upon the extra assessment upon income claimed to have been received by the petitioner during the year 1922 and omitted from his return for that period. The remainder, $15.23, was interest on said assessment at the rate of six per cent per annum from October 1, 1923. The petitioner duly paid said assessed tax and interest as determined under compulsion and protest, and duly filed an abatement claim with said Respondent Commissioner, and at a hearing upon said abatemen claim urged the contentions in support of his claim as set forth in the complaint in this proceeding. The said abatement claim and contentions were rejected by the Respondent Commissioner and registered mail notice thereof was given the petitioner, said notice being received by the petitioner on February 19, 1924.

6. In the return of the petitioner of income received by him for the year 1922 he did not include as income certain royalties, consisting of two items totalling $29,767.80, placed to his credit as hereinafter described by the Rockwood Sprinkler Company, a corporation with which he

was connected, in the month of January, 1922, as of the 31st day of December, 1921, and other royalties consisting of two items totalling $20,291.90, placed to his credit by said company on the 30th of June 1922. In this return the peti- [fol. 17] tioner's income only included his salary received from said Rockwood Sprinkler Company and another corporation herein described, amounting to $54,200; and his fees as director amounting to $120, specifically stating no receipts on account of royalties. In the same return the petitioner claimed as a deduction from his gross income depreciation or depletion on patents amounting to the sum of $100,000.

7. Upon verification of the petitioner's tax return of income received by him for the year 1922, the Income Tax Division of the Department of Taxation disallowed the depreciation of $100,000 claimed; and added to the income received the royalties placed to the credit of the petitioner by the Rockwood Sprinkler Company, above mentioned. The changes thus made by the Respondent Commissioner in the petitioner's tax return for the year 1922 are objected to by the petitioner and form the principal ground for the present action to recover payment of the assessment resulting from these changes.

8. As above stated the sum of $15.23 was added to the assessment, being interest on the extra assessment from October 1, 1923. It is not disputed that the foundation for this claim of interest rests upon the provisions of chapter 143 of the Acts of 1922, approved May 10, 1922.

9. Upon the date of the complaint and from 1906 previous the petitioner has been the President, Treasurer and principal stockholder of the Rockwood Sprinkler Company, a corporation located in said City of Worcester. From time to time prior to 1916 the petitioner has invented certain sprinkler systems protected by patents, for the manufacture and sale of which systems said corporation was organized. These patents have been put to the use of the corporation by consent of the petitioner. In return for this use the corporation has paid to the petitioner certain sums as royalties. The royalty payments have been made at irregular intervals whenever requested by the petitioner.

The rate of payments has always been based upon the units produced under the patent rights, but the rate per unit has not been uniform, being fixed from time to time by the petitioner. The petitioner also received from this corporation a weekly salary of a fixed amount paid to him each week. The petitioner's returns in the form of royalties above mentioned were paid to him in large amounts, there being only two payments made to him in the year 1921 and no payment in the year 1922.

10. In 1917 and since, there has been in existence another corporation called the Rockwood Sprinkler Company of Illinois. This company was affiliated with the first mentioned corporation, its function being to purchase the manufactured products of the Rockwood Sprinkler Company first mentioned and sell them in the parts of the country remote from its neighborhood. The petitioner has, from its inception, been the President and Treasurer of the Illinois Company also, but no direct use has been made by the Illinois Company of the petitioner's patents and no sums as royalties or otherwise have been received by, or credited to, the petitioner, from the Illinois Company for the use of the petitioner's patents.

11. In the matter of crediting the petitioner's royalties the Rockwood Sprinkler Company adopted and consistently used the following method. As soon as convenient in the settlement of accounts after the end of each calendar year the amount of royalties due to the petitioner from the articles sold by the company under the petitioner's patents [fol. 18] during the previous calendar year, was computed by the assistant treasurer who had charge of the company's books of account. These computations were then submitted to the company's accountant and then with his approval were placed to the credit of the petitioner upon the books of the company as of the year preceding. This process was done before the closing of the company's books of account for the previous year. In the verification of the return of income submitted by the petitioner for the year 1922 above mentioned, and in making the changes as described in paragraph 7 above, the additional items of royalties which were credited upon the books of the Rockwood

Sprinkler Company as of December 31, 1921 were actually made in the following January. For special reasons royalty credits were made by the company for the petitioner at other times, and the two items added by the Commissioner upon verification as credited on June 30, 1922, were made in July following. Royalties were placed to the credit of the petitioner amounting to $23,893.40 in the month of January 1923 as of December 31, 1922.

12. As stated above the payment of royalties to the petitioner was made to him when requested and in such amounts as were requested. The petitioner was willing for the company to have the use of the money due him as royalties, as it saved the company from the necessity of borrowing money. There was no evidence introduced as to whether or not the company was in sufficient funds to pay the petitioner the amounts credited to him upon the dates they were so credited; and it appeared that before the assessment complained of the income tax division had made no investigation as to the financial condition of the company. It was admitted, however, that the company was at all times solvent and its assets at all times sufficient to pay the amounts credited to the petitioner.

13. As to the application of payments made to the petitioner on account of royalties, whenever a payment on account was requested by the petitioner, it was the custom of the assistant treasurer to place such payments against the oldest unpaid credits of the petitioner. This method was adopted by the assistant treasurer as a mode of convenience and was without official sanction from the Board of Directors or other managing officers of the company. As above stated no part of the credited amounts by the Rockwood Sprinkler Company which were added by the Income Tax Division in the verification of the petitioner's tax return of the income for the year 1922 were paid to the petitioner during the year 1922.

14. As above mentioned in paragraph 7 the Commissioner disallowed a claim for a deduction on the petitioner's return for income received in 1922 on account of the depreciation or depletion on patents. The deprecia-

tion was claimed on account of the patents above referred to which were procured on inventions of the petitioner and used by the Rockwood Sprinkler Company. It is the contention of the Commissioner that the item of depreciation if allowed be based upon the original cost of the patents which so far as appears was not in excess of the sum of $2,000. It is admitted by both parties that on January 1, 1916, the patents in the aggregate, taking into consideration the varying length of time remaining for each patent, had increased to a very large amount. The agreement of the parties with relation thereto is as follows:

[fol. 19] "It is agreed that, if material, the value of the patents (referred to in the complaint) on January 1, 1916 was six hundred thousand ($600,000) dollars and thereafter on each succeeding year to and including the year 1922 the value was the said sum of six hundred thousand ($600,000) dollars less that multiple of 9.09% of six hundred thousand ($600,000) dollars which corresponds to the number of years intervening between each succeeding year and the said date, January 1, 1916."

15. The amounts assessed as above stated upon the petitioner by the respondent have been by virtue of authority claimed under chapter 62 of General Laws and acts in amendment and in addition thereto. By section 38 of this chapter it is provided "The Commissioner may from time to time, make such rules and regulations, not contrary to this chapter, as he deems necessary to carry out its provisions." The Commissioner has accordingly made rules and regulations certain of which, relative to the subject matter of this complaint, are set forth in the following paragraph.

16. The rules and regulations of the Commissioner are as follows:

"1009. Income is considered to be received for the purposes of this act when (1) it is actually paid in cash, by check or other negotiable instrument, or the equivalent of cash; (2) when it is credited by a bank or banking institution; (3) when it is credited upon the books of a broker, banker or agent of the taxpayer; (4) when it is credited upon an open or running account between the parties with

other mutual charges; (5) when payment therefor is made in merchandise or other commodities; (6) when payment therefor is made by services rendered "

"6028. Income received in the form of royalties, or in the form of other deferred payments, shall be taxable to the recipient as business income."

"6077. Royalties received by an heir of the original patentee or copyrightee are not taxable as business income."

"7032. One-seventeenth of the actual cost of securing or purchasing patent rights may be claimed as an annual allowance for the depletion thereof."

17. At the time of the acts complained of it was an established practice of the Income Tax Division of the Department of Corporations and Taxation of this Commonwealth, to regard as received, income credited to the account of a taxpayer when it could be drawn against; and where nothing appeared to the contrary to regard assets available to pay the amounts credited, and the credit a constructive receipt. If the fact of the amount to be credited could not be determined until after the closing period the division regarded the payment as made when the entry of the credit was actually made. It was also the practice to include royalties received as business income; and in the allowance for depreciation on patents yielding royalties, to determine the depreciation as one seventeenth of the cost of the patents, whether the income was received by one who purchased the patents or paid the original expense of acquiring them.

[fol. 20] 18. It is believed that the question of whether or not royalties as above described constituted taxable income in this Commonwealth; and whether, under the circumstances above, the royalties credited to the petitioner, if taxable income, were properly considered income when actually credited to the petitioner; and further if the interest assessed upon the petitioner as above described, was properly assessed under the provisions of chapter 143 of the Acts of 1922; and further if the depreciation on patents claimed by the petitioner was properly disallowed by the Commissioner; are all, in connection with the facts of the case, questions of law to be decided by the court. If, however, it should appear that the abatement as requested by

the petitioner or any part, is granted, the sum abated shall be repaid to the complainant by the State Treasurer with interest at the rate of 6% per annum from December 14, 1923 to the date of repayment.

19. At the request of the respondent I am attaching hereto Exhibit C, a schedule of the business income of the petitioner for the year 1922, with changes by the Commissioner.

Respectfully submitted.

Edwin G. Norman

In Superior Court of Worcester County.

Findings and Rulings.—Filed October 24, 1925.

These are two complaints filed under section 47, chapter 62 of the General Laws by way of appeal from the refusal of the respondent to abate an income tax assessed upon the complainant by the commissioner of corporations and taxation for income received in the year 1921, and to abate an income tax assessed upon the complainant for income received in the year 1922. The complaint numbered 27819 relates to the income for 1921, and the complaint numbered 27820 to the income for 1922, the tax for 1921, of which he complains, being assessed in 1922, and the tax for 1922 being assessed in 1923. Both cases were heard by me on the reports of a commissioner to whom they were referred by the court, and upon certain documents which were before the commissioner but were not annexed to his reports.

As to the complaint numbered 27819: The complainant's return for the year 1921, so far as material to the issues involved, was as follows:

Schedule of Business Income, George I. Rockwood

1922 tax for year 1921

Cash payments on a/c royalties	$50,000.00	
Salary Worcester Company	26,000.00	
" Chicago Company	20,000.00	
Director's fees	55.00	
Additional compensation 1920, Credit from Worcester Company	24,917.20	
Gross Income		$120,972.20

[fol. 21]

Less deductions, etc.:

Part State income tax	$822.63	
" Federal income tax	9,280.50	
Depreciation or depletion on patents	100,000.00	
Statutory exemptions	2,750.00	
		$112,853.13
		$8,119.07

It appears at the outset from paragraph 6 of the commissioner's report that in this return the complainant erroneously charged himself twice with the receipt of the sum of $20,176.48 Upon the facts reported by the commissioner in this connection, it would seem that the proper correction of this error would require the item "cash payments on account royalties $50,000" to be amended by reducing it to $29,823.52, thus changing the item of total gross income from $120,972.20 to $100,795.72.

Under the heading "deductions," the complainant included an item "depreciation or depletion on patents $100,000," meaning the patents which produced the royalties mentioned in the previous item. Upon verification of the complainant's return, the respondent disallowed this item, assessed the tax at 1½% on $108,119.07 and to the tax thus assessed added interest at six per cent from October 1, 1922, which the complainant paid on December 14, 1923. the whole amount being $1,605.

The first and principal question which arises is whether the complainant was taxable on his income for royalties,

fixed in his return at $50,000, but which when corrected, as I have said, should have been stated as $29,823.52.

It seems to be generally held (see Cooley on Taxation, vol. 2, § 618, and cases collected in note, and In re Sheffield, 64 Fed. 833) that it is not competent for the states to tax patent rights conferred by the United States. It would seem doubtful, therefore, whether they can tax the income which a patentee or his assignee derives directly from leasing to others the right to manufacture under his patent. See Gillespie vs. Oklahoma, 257 U. S. 501, 506. Whatever the correct view may be in this respect, I find and rule on the findings of the commissioner that in this case the income from the royalties was not income from business, and not being income from any of the kinds of "intangible personal property" specified in the income tax law, was not taxable. The complainant's return, therefore, should have omitted the item of income from royalties, and consequently should have omitted, also, the item of depreciation or depletion on the patents from which the royalties were obtained (see Gen. Laws, c. 62, § 6, cl. b), the provision in said section 6 of chapter 62 for a reasonable allowance for depreciation and obsolescene of property, applying, as I construe it, only to property from which taxable income is derived, or to assets owned and used in a business from which such income is derived. The total of gross income, therefore, should have been stated at $70,972.20; and the total of deductions at $12,853.13, the complainant being taxable at 1½% on the difference, viz., on $58,119.07, one and one half per cent of which is $871.68. To this amount interest at six per cent should be added under St. 1922, c. 143, from October 1, 1922, this statute, as I rule against the contention of the complainant, being applicable to the present case.

[fol. 22] As to the complaint numbered 27820: This relates, as I have said, to the refusal of the commissioner of corporations and taxation to abate the income tax assessed upon the complainant for his income in the year 1922. His return for that year, so far as material, was as follows:

Schedule of Business Income, George I. Rockwood

1923 Tax for Year 1922

Cash payments on account royalties	None	
Salary a/c paid by Worcester Co.	$24,200.00	
" " " " Chicago Co.	30,000.00	
Director's fees	120.00	
Gross Income		$54,320.00
Less deductions, etc.:		
Part State income tax	$121.79	
Depreciation or depletion on patents	100,000.00	
Statutory exemptions, etc.	2,750.00	
		102,871.79
Taxpayer's net income taxable at 1½% (loss)		48,551.79

The complainant stated, as it appears, that he received no cash payments on account of royalties, reported the receipt of other income, salaries and director's fees, and among other items, included an item of deduction "for depreciation or depletion on patents" in the sum of $100,000. The commissioner of corporations and taxation disallowed this item of depreciation and assessed him on royalties amounting to $50,059.60, describing them as credited to the complainant on the books of the Rockwood Sprinkler Company, some in 1921 and some in 1922, and all as having become "available" to the complainant in 1922; treated them as income received, and fixed his net taxable income for the year 1922 at $101,507.81, taxing him at the rate of 1½% of this amount with interest from October 1, 1922. These royalties were credited to the complainant on the books of the Rockwood Sprinkler Company for the year 1922, but were not actually received by him. The complainant paid this tax on December 14, 1923, the whole amount being $1,537.85.

I find and rule, first, as I ruled in the case of the complaint numbered 27819, apart from the question whether these royalties were received within the meaning of the income tax law, that, under the circumstances reported by the commissioner, they were not income from business, nor

income from any of the kinds of intangible personal property specified in the income tax law, and therefore not assessable. Secondly, apart from the question whether the royalties were income from business or from property, I rule, under the circumstances reported by the commissioner, that they were not income received within the meaning of the income tax law.

If I am correct in these views, the claimed depreciation and depletion in the value of the patents from which the royalties were derived, should not be allowed for the reasons given in connection with the 1921 tax; the net taxable income of the complainant should be stated at $51,448.21, [fol. 23] and his tax, reckoned at one and a half per cent thereof, fixed at $771.72, with interest at six per cent from October 1, 1922, to the date when he paid it.

On December 14, 1923, on the assessment of the commissioner of corporations and taxation, the complainant paid the tax for the year 1921 in the sum of $1,605. Deducting therefrom the sum of $871.68, the correct amount for which I find he was assessable, and interest thereon at six per cent from October 1, 1922 to December 14, 1923, the date when he paid, I find on the complaint numbered 27819 that the complainant is entitled to an abatement of $671, and to be repaid this amount by the state treasurer, with interest at the rate of six per cent from December 14, 1923, and costs.

On the assessment of the commissioner, the complainant paid the tax for income received in the year 1922 in the sum of $1,537.85. Deducting from this the sum of $771.72, for which I find he was assessable, and interest thereon from October 1, 1923 to December 14, 1923, when he paid, I find on the complaint numbered 27820 that the complainant is entitled to an abatement of $756.95, and to be repaid this amount by the state treasurer, with interest at the rate of six per cent from December 14, 1923, and costs.

John D. McLaughlin, J. S. C.

(Exhibits not attached except to copies for Full Court.)

[fol 24] IN SUPERIOR COURT OF WORCESTER COUNTY

EXHIBIT B

E. G. N.

Schedule of Business Income, George I. Rockwood

1922 Tax for year 1921

Returned by taxpayer:

Cash payments on a/c royalties	$50,000.00	
Salary Worcester Company	26,000.00	
" Chicago Company	20,000.00	
Director's fees	55.00	
Additional compensation 1920, Credit from Worcester Company	24,917.20	
Gross Income		$120,972.20
Less deductions, etc.:		
Part State income tax	$822.63	
" Federal income tax	9,280.50	
Depreciation or depletion on patents	100,000.00	
Statutory exemptions	2,750.00	
		112,853.13
Taxpayer's Net Income taxable at 1½%		$8,119.07
To which Respondent Commissioner added:		
Disallowance of depreciation or depletion of patents		100,000.00
Respondent Commissioner's adjusted net taxable income		$108,119.07

(Here follows analysis of account of George I. Rockwood, marked side folio page 25.)

[fols. 26 & 26½] EXHIBIT C

E. G. N.

Schedule of Business Income, George I. Rockwood

1923 Tax for Year 1922

Returned by taxpayer:		
Cash payments on account royalties	None	
Salary a/c paid by Worcester Co.	$24,200 00	
Salary a/c paid by Chicago Co.	30,000 00	
Director's fees	120 00	
Gross Income		$54,320 00
Less deductions, etc.:		
Part State income tax	$121 79	
Depreciation or depletion on patents	100,000 00	
Statutory exempts, etc.	2,750 00	
		102,871 79
Taxpayer's net income taxable at 1½% (loss)		$48,551 79
To which Respondent Commissioner added:		
Disallowance of depreciation and depletion on patents	$100,000 00	
Sprinkler head royalties credited 12/31/21 and "available" 1922	19,227 70	
Dry pipe valve royalties credited 12/31/21 and "available" 1922	10,540 00	
Sprinkler head royalties credited 6/30/22 and "available" 1922	11,561 90	
Dry pipe valve royalties credited 6/30/22 and "available" 1922	8,730 00	
		$150,059 60
Respondent Commissioner's adjusted net taxable income		$101,507 81

A copy. Attest: Frank L. Dean, Clerk.

[fols. 27 & 27½] In Supreme Judicial Court of Massachusetts

In the Case of

George I. Rockwood

vs.

Henry F. Long (Commissioner of Corporations & Taxation),

Pending in the Superior Court for the County of Worcester

Order Overruling Exceptions—November 27, 1926

Ordered, that the clerk of said court in said county make the following entry under said case in the docket of said court, viz: Exceptions overruled.

By the Court.

Walter F. Frederick, Clerk.

Brief Statement of the Grounds and Reason of the Decision

See opinion on file.

Filed Nov. 30, 1926. Attest: Frank L. Dean, Clerk.

[fols. 28 & 28½] In Supreme Judicial Court of Massachusetts

In the Case of

George I. Rockwood

vs.

Henry F. Long (Commissioner of Corporations & Taxation),

Pending in the Superior Court for the County of Worcester

Order Overruling Exceptions—November 27, 1926

Ordered, that the clerk of said court in said county make the following entry under said case in the docket of said court, viz: Exceptions overruled.

By the Court.

Walter F. Frederick, Clerk.

Brief Statement of the Grounds and Reason of the Decision

See opinion on file.

Filed Nov. 30, 1926. Attest: Frank L. Dean, Clerk.

[fol. 29] In Supreme Judicial Court of Massachusetts

Opinion

Carroll, J.:

In these two complaints the decisive question is the right of the Commonwealth to tax the income received from royalties for the use of patents issued by the United States. The complaints are against the commissioner of corporations and taxation for the abatement of income taxes assessed for income received in the years 1921 and 1922. The judge of the Superior Court found for the complainant; the respondent excepted.

The complainant, a resident of Worcester for several years, was the president and principal stockholder of the

Rockwood Sprinkler Company, a corporation located at Worcester, and of the Rockwood Sprinkler Company of Illinois. He invented, from time to time prior to the year 1916, certain sprinkler systems protected by patents. From these he received royalties, which were paid to him by the Worcester company for the use of the patents.

A patent right itself is not taxable by a State. Letters patent of the United States give to the patentee a right of monopoly in the invention, with this right the State cannot interfere. It is conceded by the respondent that the rights secured by the patents could not be taxed by the State without the consent of Congress. Webber v. Virginia, 103 U. S. 344, 347. M'Culloc v. State of Maryland, 4 Wheat. 316, 432. Opinion of the Justices, 193 Mass. 605, 608, 609. People v. Assessors, 156 N. Y. 417, 418.

As a State cannot tax the patent, it cannot tax the royalties received from its use. What the State cannot do directly, it cannot accomplish in an indirect way. The true [fol. 30] nature of the Tax must be considered. A tax on rents received from land is the same in substance as a tax on the land itself. Rights under patents could be impaired or destroyed if taxed by the State, and if royalties from patents can be taxed, the right itself might thereby be destroyed. The Legislature, in giving a tax a particular name, cannot "take away our duty to consider its real nature and effect." See Choctaw, Oklahoma & Gulf Railroad v. Harrison, 235 U. S. 292, 298; Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 581.

In Gillespie v. State of Oklahoma, 257 U. S. 501, 506, where it was held that, a tax upon a lease of Indian lands being invalid, a tax upon the income received from the lease is invalid, it was said: "The same considerations that invalidate a tax upon the leases invalidate a tax upon the profits of the leases * * * a tax upon such profits is a direct hamper upon the effort of the United States to make the best terms that it can for its wards." "A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them." Indian Territory Illuminating Oil Co. v. State of Oklahoma, 240 U. S. 522, 530. "A tax upon the income of property is in reality a tax upon the property itself." Opinion of the Justices, 220 Mass. 613, 624.

A patented article, when manufactured, may be taxed by the State. A tax on such property, however, is not a tax on the privilege granted to the patentee by the Federal government. The right to exclude others from making or selling the patented article is not interfered with by a tax on the patented article when made. Webber v. Virginia, supra. It has been decided that a Federal estate tax may be assessed on an estate in which were included State and municipal bonds. "The transfer upon death is taxable, whatsoever the character of the property transferred and to whomsoever the transfer is made." Greiner v. Lewellyn, 258 U. S. 384, 387. But the tax levied on the royalties in the cases at bar was in effect a tax on the patent itself. It was a property tax, Hart v. Tax Commissioner, 240 Mass. 37, 39, and was beyond the power of the State.

United States Glue Co. v. Town of Oak Creek, 247 U. S. 321, 326, is not in conflict. In that case it was said, "A [fol. 31] State may not directly burden interstate commerce, either by taxation or otherwise. But a tax that only indirectly affects the profits or returns from such commerce, is not within the rule." This case was distinguished in Gillespie v. Oklahoma, supra. "The criterion of interference by the States with interstate commerce is one of degree. It is well understood that a certain amount of reaction upon and interference with such commerce cannot be avoided if the States are to exist and make laws. * * * The rule as to instrumentalities of the United States on the other hand is absolute in form and at least stricter in substance." Gillespie v. Oklahoma, supra, at 505. We find nothing in Fidelity & Deposit Co. of Maryland v. Commonwealth of Pennsylvania, 240 U. S. 319, and similar cases cited on the respondent's brief, inconsistent with what is here decided. As the income from royalties on the patents issued by the United States were not taxable, the exceptions of the respondent are overruled. It becomes unnecessary, therefore, to consider the other questions argued by the complainant and respondent.

In each case the entry must be: Exceptions overruled.

COMMONWEALTH OF MASSACHUSETTS:

Boston, February 17, 1927.

I certify the foregoing to be a true copy of the opinion of the Supreme Judicial Court in the two cases of George I. Rockwood vs. Commissioner of Corporations and Taxation, decided on the twenty-seventh day of November, 1926.

Ethelbert V. Grabill, Reporter of Decisions.

[fol. 32] IN SUPERIOR COURT OF WORCESTER COUNTY

#27819

GEORGE I. ROCKWOOD

v.

HENRY F. LONG, Commissioner Corporations & Taxation

JUDGMENT—Filed December 27, 1926

Abatement for $799.04 is granted, that amount having been paid on December 14, 1923, together with interest thereon at the rate of 6% per annum from the date of payment, and costs of suit taxed at $93. Shall be paid to the complainant by the State Treasurer in accordance with General Laws, Chapter 62, Section 47, as amended by Chapter 287 Acts of 1926.

By the Court.

Frank L. Dean, Clerk.

December 24, 1926.

The above order may be entered. John D. McLaughlin, Justice Superior Court.

[File endorsement omitted.]

[fol. 33] In Superior Court of Worcester County

#27820

George I. Rockwood

v.

Henry F. Long, Commissioner Corporations & Taxation

Judgment—Filed December 27, 1926

Abatement for $756.95 is granted, that amount having been paid on December 14, 1923, together with interest thereon at the rate of 6% per annum from the date of payment, and costs of suit taxed at $43.00 shall be paid to the complainant by the State Treasurer in accordance with General Laws, Chapter 62, Section 47, as amended by Chapter 287 Acts of 1926.

By the Court.

Frank L. Dean, Clerk.

December 24, 1926.

The above order may be entered. John D. McLaughlin, Justice Superior Court.

[File endorsement omitted.]

[fol. 34] In Superior Court of Worcester County

No. 27819, No. 27820

[Title omitted]

Motion for Stay of Execution and Other Processes—Filed February 7, 1927

Now comes the defendant in the above-entitled actions and moves that the issuance by this court of any execution or other process subsequent to final judgment after rescript in said causes be stayed until said causes shall have been passed upon by the Supreme Court of the United

In Both Cases

	Credits	1920
Credit Balance Dec. 31, 1919:		
Royalties of 1918	$100,000.00	.....
Royalties of 1919 D. P. V.	21,360.00	$16,883.68
Royalties of 1919 Sprinkler	25,347.20	.....
Add: Compensation 1919	21,116.32	21,116.32
Item error adjusted in 1920	7.49	.....
Total Credit Balance Dec. 31, 1919	$167,816.03	.....
1920 Credits:		
*Salary Paid weekly	$26,500.00	26,500.00
Add: Compensation Credit Dec. 31, 1920	24,917.20	.....
Royalties Sprinkler Co. Dec. 31, 1920-Cr.	28,264.90	.....
Royalties D. P. V. Credit Dec. 31, 1920	21,630.00	.....
Adjustment Error of 1919	7.49	.....
	$101,319.59	.....
1921 Credits:		
*Salary Paid weekly	$26,000.00	.....
Royalties Sprinkler Co. Cr. Dec. 31, 1921	19,227.70	.....
Royalties D. P. V. Cr. Dec. 31, 1921	10,540.00	.....
	$55,767.70	.....
1922 Credits:		
*Salary Paid weekly	$24,200.00	.....
Royalties Sprinkler Co. Cr. June 30, 1922	11,561.90	.....
Royalties D. P. V. Cr. June 30, 1922	8,730.00	.....
Royalties Sprinkler Co. Cr. Dec. 31, 1922	9,663.40	.....
Royalties D. P. V. Cr. Dec. 31, 1922	14,230.00	.....
Item Error adjusted in 1923	8.50	.....
	$68,375.80	.....
1923 Credits:		
*Salary Paid weekly	$15,600.00	.....
Royalties Sprinkler Co. Cr. Dec. 31, 1923	37,618.40	.....
Royalties D. P. V. Cr. Dec. 31, 1923	31,930.00	.....
Adjustment Error 1922	8.50	.....
	$85,156.90	.....
Yearly Totals of Payments	.....	$64,500.00

*Note.—Salary paid weekly was neither credited nor charged by the company to

Analysis of Account of George I. Rockwood on Books of Roc

In Both Cases, 27819 and 27820

	Credits	Application of pa		
		1920	1921	1922
c. 31, 1919:				
918	$100,000.00	.....	.....	.....
919 D. P. V.	21,360.00	$16,883.68	$4,476.32	.....
919 Sprinkler	25,347.20	.....	25,347.20	.....
sation 1919	21,116.32	21,116.32	.....	.....
usted in 1920	7.49	.....	.....	.....
redit Balance Dec. 31, 1919	$167,816.03	.....	.....	.....
weekly	$26,500.00	26,500.00	.....	.....
sation Credit Dec. 31, 1920	24,917.20	.....	20,176.48	.....
nkler Co. Dec. 31, 1920-Cr.	28,264.90	.....	.....	.....
V. Credit Dec. 31, 1920	21,630.00	.....	.....	.....
rror of 1919	7.49	.....	.....	.....
	$101,319.59	.....	.....	.....
weekly	$26,000.00	.....	26,000.00	.....
nkler Co. Cr. Dec. 31, 1921	19,227.70	.....	.....	.....
V. Cr. Dec. 31, 1921	10,540.00	.....	.....	.....
	$55,767.70	.....	.....	.....
weekly	$24,200.00	.....	.....	$24,200.0
kler Co. Cr. June 30, 1922	11,561.90	.....	.....	.....
V. Cr. June 30, 1922	8,730.00	.....	.....	.....
nkler Co. Cr. Dec. 31, 1922	9,663.40	.....	.....	.....
V. Cr. Dec. 31, 1922	14,230.00	.....	.....	.....
usted in 1923	8.50	.....	.....	.....
	$68,375.80	.....	.....	.....
eekly	$15,600.00	.....	.....	.....
kler Co. Cr. Dec. 31, 1923	37,618.40	.....	.....	.....
V. Cr. Dec. 31, 1923	31,930.00	.....	.....	.....
ror 1922	8.50	.....	.....	.....
	$85,156.90	.....	.....	.....
otals of Payments	.....	$64,500.00	$76,000.00	$24,200.0

paid weekly was neither credited nor charged by the company to George I. Rockwood

Rockwood Sprinkler Co.

of payments 22	1923	1924	Actual dates and amounts of payments	
....	.....	.....		
....	.....	.....		
....	.....	.....		
....	.....	.....		
....	.....	.....		
....	.....	.....		
			1920.	
....	.....	.....	April 4	$3,000.00
....	$4,740.72	.....	May 27	10,000.00
....	28,264.90	.....	June 14	15,000.00
....	21,630.00	.....	Oct. 4	10,000.00
....	.....	.....	Salary Paid, $500 every week	26,500.00
....	.....	.....	....	$64,500.00
			1921.	
....	15,364.38	$3,863.32	June 21	$20,000.00
....	.....	10,540.00	Oct. 1	30,000.00
....	.....	.....	Salary Paid, $500 every week	26,000.00
				$76,000.00
00.00	.....	.....		
....	.....	.....	1922.	
....	.....	596.68	Salary paid every week:	
....	.....	.....	$500 part year }	$24,200.00
....	.....	.....	$300 " " }	
....	.....	.....	No other payments.	
....	.....	.....		$24,200.00
			1923.	
....	15,600.00	.....	May 25	$10,000.00
....	.....	.....	Oct. 11	50,000.00
....	.....	.....	Dec. 17	5,000.00
....	.....	.....	Dec. 31	5,000.00
....	.....	.....	Salary paid, $300 every week	15,600.00
00.00	$85,600.00	$15,000.00		$85,600.00

ood Account, but charged directly to Expense from Cash.

States, to which court the defendant is in process of taking said causes by petition for writs of certiorari.

By His Attorney, F. Delano Putnam, Assistant Attorney General.

The foregoing motion is assented to.

Gage, Hamilton, June & White, Merrill S. June, Attorneys for Plaintiff.

Feb. 7, 1927.
Filed. Attest: Frank L. Dean, Clerk.

Allowed: Philip J. O'Connell, J. S. C.

[fol. 35] In Superior Court of Worcester County

No. 27819

[Title omitted]

Docket Entries

1923 D

Counsel for plaintiff: Smith, Gage & Dresser; Gage, Hamilton, June & White.
Counsel for defendant: Attorney General.

Feb. 28, 1924.	1. Complaint filed—notice ordered to issue ret. Mar. 20, 1924, service to be made 14 days before ret. day—notice issued as ordered.
Mar. 10, 1924.	2. Return of service.
Mar. 11, 1924.	3. Appearance for deft.
Apr. 10, 1924.	4. Ans.
May 15, 1924.	Edwin G. Norman, Esq. appt'd Commissioner—report to be filed on or before Sept. 1, 1924. Rule issued.
Oct. 28, 1924.	5. Agreement of certain facts.
Nov. 14, 1924.	6. Time for completion of hearings before Commissioner & filing of report extended to & incl. Feb. 9, 1925.

Feb. 9, 1925.	7. Time for completion of hearings before Commissioner & filing report extended to & incl. June 1, 1925.
June 1, 1925.	8. Commissioner's report.
Oct. 24, 1924.	9. Court finds that the complainant is entitled to an abatement of $671 and to be repaid this amount by the State treasurer, with interest at the rate of six per cent from Dec. 14, 1923 and costs. (McLaughlin, J.)
	10. Findings and rulings.
Oct. 24, 1925.	11. Deft.'s exceptions to rulings.
Oct. 30, 1925.	12. Deft.'s exception to failure to rule.
Nov. 11, 1925.	13. Deft.'s bill of exceptions.
Dec. 2, 1925.	" " " " all'd.
	14. Stipulation.
Nov. 30, 1926.	15. Rescript received, viz: "Exceptions overruled."
Dec. 27, 1926.	16. Final order.
Feb. 7, 1927.	Judgment.
Feb. 7, 1927.	17. Deft.'s mo. for stay of execution & other processes filed & all'd. (O'Connell, J.)

[fol. 36] In Superior Court of Worcester County

No. 27820

[Title omitted]

Docket Entries

1923 D

Counsel for plaintiff: Smith, Gage & Dresser; Gage, Hamilton, June & White.

Counsel for Defendant: Attorney General.

Feb. 28, 1924.	1. Complaint filed—notice ordered to issue ret. Mar. 20, 1924, service to be made 14 days before ret. day: notice issued as ordered.

Mar. 10, 1924.	2. Return of service.
Mar. 11, 1924.	3. Appearance for deft.
Apr. 10. 1924.	4. Ans.
May 15, 1924.	Edwin G. Norman, Esq. appt'd Commissioner—report to be filed on or before Sept. 1, 1924. Rule issued.
Oct. 28, 1924.	5. Agreement of certain facts.
Nov. 14, 1924.	6. Time for completion of hearings before Commissioner & filing of report extended to & incl. Feb. 9, 1925.
Feb. 9, 1925.	7. Time for completion of hearings before Commissioner & filing of report extended to & incl. June 1, 1925.
June 1, 1925.	8. Commissioner's report.
Oct. 24, 1925.	9. Court finds that the complainant is entitled to an abatement of $756.95 and to be repaid this amount by the State treasurer, with interest at the rate of six per cent from December 14, 1923 and costs (McLaughlin, J.) See memo. in #27819.
Oct. 27, 1925.	10. Deft.'s exceptions to rulings.
Oct. 30, 1925.	11. Deft.'s exception to failure to rule.
Nov. 11, 1925.	12. Deft.'s bill of exceptions.
Dec. 2, 1925.	" " " " all'd.
Nov. 30, 1926.	13. Rescript received, viz: "Exceptions overruled."
Dec. 27, 1926.	14. Final order.
Feb. 7, 1927.	Judgment.
Feb. 7, 1927.	15. Deft.'s mo. for stay of execution & other processes filed & allowed (O'Donnell, J.)

[fol. 37] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 38] Judge's certificate to clerk omitted in printing.

SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1927

No. 201

ORDER ALLOWING CERTIORARI—Filed April 25, 1927

The petition herein for a writ of certiorari to the Superior Court, County of Worcester, of the State of Massachusetts, is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1927

No. 202

ORDER ALLOWING CERTIORARI—Filed April 25, 1927

The petition herein for a writ of certiorari to the Superior Court, County of Worcester, of the State of Massachusetts, is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

MAR 24 1917
JAMES D. MAHONEY
CLERK

SUPREME COURT OF THE UNITED STATES

[redacted] 201

HENRY F. LONG, Commissioner of Conservation and Director of the Conservation of Game, Oregon, Petitioner,

vs.

GEORGE F. ROCKWOOD, Respondent.

[redacted] 202

HENRY F. LONG, Commissioner of Conservation and Director of the Conservation of Game, Oregon, Petitioner,

vs.

GEORGE F. ROCKWOOD, Respondent.

INDEX.

	Page
Petition for writs of certiorari	1
Short statement of matter involved	2
Reasons relied on for issuance of writs	3
Brief in support of petition	7

Table of Cases Cited.

Choctaw & Gulf R. R. v. Harrison, 235 U. S., 292	8
Excelsior Wooden Pipe Co. v. Pacific Bridge Co., 185 U. S., 282	11
Gillespie v. Oklahoma, 257 U. S., 501	8, 9
Greiner v. Lewellyn, 258 U. S., 384	11
Hump Hairpin Co. v. Emmerson, 258 U. S., 290	8, 9
Indian Oil Co. v. Oklahoma, 240 U. S., 522	8
Jaybird Mining Co. v. Weir, 271 U. S., 609	8
Jordan v. Overseers of Dayton, 4 Ohio, 295	12
Luckett v. Delpark, 270 U. S., 496	11
Marsden Co. v. Board of Assessors, 61 N. J. L., 461	11
Patterson v. Kentucky, 97 U. S., 501	12
People ex rel. Edison Electric Illuminating Co. v. Board of Assessors, 156 N. Y., 417	11
People ex rel. Edison Electric Light Company v. Campbell, 138 N. Y., 543	11
People ex rel. United States Aluminum Company v. Knight, 174 N. Y., 475	11
Shaffer v. Carter, 252 U. S., 37	8, 10
United Shoe Machinery Co. v. United States, 258 U. S., 451	12
United States Glue Co. v. Oak Creek, 247 U. S., 321	8, 10
Webber v. Virginia, 103 U. S., 344, 347	11
Wilson v. Sandford, 10 How., 99	11

Table of Statutes Cited.

General Laws of Massachusetts, Section 47 of Chapter 62	2
Judicial Code, Section 237, as amended by the Act of Congress of February 13, 1925	5

Other Authorities Cited.

Gray on Limitations of Taxing Power, pp. 393, 394	12

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1926.

No. 993.

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION OF THE COMMONWEALTH OF MASSACHUSETTS, PETITIONER,

v.

GEORGE I. ROCKWOOD, RESPONDENT.

OCTOBER TERM, 1926.

No. 994.

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION OF THE COMMONWEALTH OF MASSACHUSETTS, PETITIONER,

v.

GEORGE I. ROCKWOOD, RESPONDENT.

Petition for Writs of Certiorari to the Superior Court of the Commonwealth of Massachusetts for the County of Worcester.

To the Honorable the Supreme Court of the United States:

Your petitioner, Henry F. Long, Commissioner of Corporations and Taxation of the Commonwealth of Massachusetts, respectfully represents as follows:

Short Statement of Matter Involved.

The respondent, George I. Rockwood, of Worcester, in said Commonwealth, is the complainant in two complaints filed on February 28, 1924 (R. 3, 17), in the Superior Court of said Commonwealth against your petitioner, under Section 47 of chapter 62 of the General Laws of Massachusetts, appealing from the refusal of your petitioner to abate additional income taxes for the years 1922 and 1923, assessed by your petitioner under the provisions of said chapter on income received by the complainant during the years 1921 and 1922 respectively (R. 3-6, 17-19). Included in the income so assessed was income from royalties received by the respondent from the Rockwood Sprinkler Company (R. 9, 22-23), a corporation located in said Worcester, of which the respondent for many years has been the president, treasurer, and principal stockholder. From time to time prior to 1916 the respondent invented certain sprinkler systems protected by patents, for the manufacture and sale of which systems the corporation was organized (R. 10, 23). These inventions have been used by the corporation with the consent of the respondent, and in return for this use the royalties referred to were paid.

In his complaints the complainant (respondent herein) alleged as one of the grounds for his contentions that "the patents granted and the royalties therefrom received by complainant * * * are not taxable under said chapter 62 (as amended), and there was error to include said royalties as subject to tax" (R. 5, 19).

Your petitioner's answers to said complaints denied that the complainant's contentions and grounds for contentions were true and alleged that the additional taxes assessed were in every respect legal and valid (R. 7, 20).

Pursuant to the requirements of the statutes of Massachusetts, the cases were referred to a commissioner to hear the parties and report the evidence. Upon the filing of the commissioner's reports the cases were heard in the superior court and findings and rulings were made to which your petitioner duly excepted (R. 28-32).

On your petitioner's bills of exceptions the cases were taken before the full court of the Supreme Judicial Court of the Commonwealth of Massachusetts and said exceptions were overruled (R. 36). Said decision is reported in Massachusetts Advance Sheets, 1926, page 2135. The ground of the decision, as shown by the opinion of said court, was that the tax levied on the royalties received by the respondent was in effect a tax on the patents for which the royalties were paid, which was beyond the power of the State (R. 37).

Following the rescript from the full court final orders were entered in the superior court on December 27, 1926, granting an abatement (R. 40).

The superior court is the highest court of the State in which a decision of the suit could be had.

Reasons Relied on for Allowance of Writs.

Upon this statement of the facts and the record in the cases your petitioner submits that the judgments

of the Superior Court of the Commonwealth of Massachusetts are erroneous, and that a review on writs of certiorari should be granted for these reasons:

(1) Because the cause is one wherein a final judgment has been rendered by the highest court of Massachusetts in which a decision could be had where a title, right, privilege, or immunity is specially set up or claimed by the complainant under the Constitution or statutes of or authority exercised under the United States.

(2) Because the full court of the supreme judicial court erred in holding that a tax on income received from royalties paid under a license or other contract for the use of rights secured by patents is beyond the power of the State to impose.

(3) Because the State court has decided a Federal question of substance not heretofore determined by this Court.

(4) Because the decision of the State court is not in accord with applicable decisions of this Court.

(5) Because the question whether income from royalties paid for the use of rights derived from or protected by patents, copyrights, and other similar privileges granted by the United States may be taxed by a State is a question of public interest and importance on which there is no direct authority known to your petitioner aside from the decision in question.

(6) Because, as your petitioner is advised, it has been the practice to tax such income in States where taxes on income are levied.

Wherefore your petitioner respectfully prays that writs of certiorari be issued to require that said causes be certified to this Honorable Court for review and determination, pursuant to the provisions of Section 237 of the Judicial Code as amended by the Act of February 13, 1925.

HENRY F. LONG,
Commissioner of Corporations and Taxation of the Commonwealth of Massachusetts,
By ARTHUR K. READING,
Attorney General of the Commonwealth of Massachusetts.
F. DELANO PUTNAM,
Assistant Attorney General of the Commonwealth of Massachusetts.

ALEXANDER LINCOLN,
Of Counsel.

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1926.

No. 993.

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION, PETITIONER,

v.

GEORGE I. ROCKWOOD, RESPONDENT.

OCTOBER TERM, 1926.

No. 994.

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION, PETITIONER,

v.

GEORGE I. ROCKWOOD, RESPONDENT.

BRIEF FOR PETITIONER.

The date of the judgment or final order to be reviewed was December 27, 1926 (R. 40).

The decision of the Massachusetts court, as shown by the opinion of the supreme judicial court (R. 36), is

based on the supposed analogy of the following three decisions of this Court:

Choctaw & Gulf R. R. v. Harrison, 235 U. S. 292.
Indian Oil Co. v. Oklahoma, 240 U. S. 522.
Gillespie v. Oklahoma, 257 U. S. 501.

To those three cases there should be added the following recent case:

Jaybird Mining Co. v. Weir, 271 U. S. 609.

The petitioner submits that those cases are to be distinguished, and that the point in question is governed by cases like the following:

United States Glue Co. v. Oak Creek, 247 U. S. 321.
Shaffer v. Carter, 252 U. S. 37.
Hump Hairpin Co. v. Emmerson, 258 U. S. 290.

The distinction is as follows:

In cases of the former class the tax in dispute was held by the court to be invalid as an attempt to tax an agency or instrumentality of the United States. In each of the four cases the instrumentality was a lessee of mines belonging to Indian wards of the Federal Government. In *Choctaw & Gulf R. R. v. Harrison, supra*, the tax was attempted to be levied on gross receipts from business under the lease; in *Indian Oil Co. v. Oklahoma, supra*, it was assessed in effect on the lessee's interest in the lease; in *Gillespie v. Oklahoma, supra*, it was laid on net income derived from the lease,

and in *Jaybird Mining Co. v. Weir, supra,* the tax was an *ad valorem* tax assessed to the lessee on ores mined by the lessee and on the land.

On the other hand, where the objection to a tax is that it interferes with the exercise of a power given to Congress by the Constitution, this Court has always distinguished interference which in the Court's view places an undue burden on the object of the power from that which does not. With respect to interstate commerce the rule has recently been stated by this Court in these words:

> "While a State may not use its taxing power to regulate or burden interstate commerce, * * * on the other hand it is settled that a State excise tax which affects such commerce, not directly, but only incidentally and remotely, may be entirely valid where it is clear that it is not imposed with the covert purpose or with the effect of defeating Federal constitutional rights."
>
> *Hump Hairpin Co. v. Emmerson, supra,* page 294.

The distinction between interference with an instrumentality of the United States and interference with Federal power over interstate commerce was explained in *Gillespie v. State of Oklahoma, supra,* page 505, where the court said:

> "The criterion of interference by the States with interstate commerce is one of degree. It is well understood that a certain amount of reaction upon and interference with such commerce cannot be avoided if the States are to

> exist and make laws. • • • The rule as to instrumentalities of the United States, on the other hand, is absolute in form and at least stricter in substance. • • •
>
> "In cases where the principal is absolutely immune from interference an inquiry is allowed into the sources from which net income is derived and if a part of it comes from such a source the tax is *pro tanto* void."

But where the interference is with the exercise of a constitutional power, such as the power of interstate commerce, the rule is just the opposite. In *United States Glue Co. v. Oak Creek, supra,* a tax on net income of a domestic corporation derived in part from interstate commerce was sustained on the ground that such a tax, where there is no discrimination, does not directly burden interstate commerce, and the court declared that the difference in effect between a tax measured by gross receipts and one measured by net income "affords a convenient and workable basis of distinction" between a direct and immediate burden and one which is only indirect and incidental. The rule thus laid down was followed in *Shaffer v. Carter, supra.*

The principle established by these cases, it is submitted, is applicable to patents as well as to interstate commerce, that the power over the subject given to Congress by the Constitution may not be interfered with directly by the exercise by a State of its power to tax; but where such interference is only remote and indirect the tax is valid.

For this reason the State may tax a patented article where it is located.

Webber v. Virginia, 103 U. S. 344, 347.

People ex rel. Edison Electric Illuminating Co. v. Board of Assessors, 156 N. Y. 417.

Again it may levy an excise tax measured by property, which includes patents.

People ex rel. Edison Electric Light Co. v. Campbell, 138 N. Y. 543, 547.

People ex rel. United States Aluminum, etc., Co. v. Knight, 174 N. Y. 475.

Marsden Co. v. Board of Assessors, 61 N. J. L. 461.

Cf. *Greiner v. Lewellyn*, 258 U. S. 384, 387.

Income from royalties paid for the use of a patented invention is derived directly from the contract between the licensee and the owner of the patent and not from the patent right itself. So a suit to recover royalties under a license is not a suit arising under the patent laws and may not be brought in the Federal court unless there is diversity of citizenship.

Wilson v. Sandford, 10 How. 99.

Excelsior Wooden Pipe Co. v. Pacific Bridge Co., 185 U. S. 282, 285.

Luckett v. Delpark, 270 U. S. 496.

The franchise secured by a patent and thus within the field of congressional power is "the right to ex-

clude others from making, using, or vending the thing patented without the permission of the patentee."

United Shoe Machinery Co. v. United States, 258 U. S. 451, 463.

Patterson v. Kentucky, 97 U. S. 501, 507.

A tax imposed on income from royalties paid under a license given by the owner of a patent, it is submitted, interferes at most only indirectly and remotely with the patent right. It lessens to some extent, no doubt, the amount of income which the patentee would otherwise receive from his invention, but it diminishes to no degree the right given him by Congress, in the exercise of its constitutional power, to "exclude others from making, using, or vending the thing patented." That right is just as complete whether or not the income is taxed. The tax does not make the privilege less exclusive.

See also

Jordan v. Overseers of Dayton, 4 Ohio 295 (cited in *Patterson v. Kentucky*, 97 U. S. 501, 507).

Gray, *Limitations of Taxing Power*, pp. 393, 394.

It is, therefore, submitted that a tax laid by a State without discrimination on the income of its citizens may include, with other income, income from royalties.

So far as counsel are aware there is no decided case outside of the decision of the Massachusetts court in which the question of the taxability by a State of in-

come from royalties has been considered and determined. As the petitioner is informed and alleges, it has been the practice in other States, as well as in Massachusetts, to include in taxable income income from royalties received by an owner of a patent or copyright. The question whether this class of income is taxable, it is submitted, is an important one, which should be finally determined by this Honorable Court.

Respectfully submitted,

ARTHUR K. READING,
Attorney General of the Commonwealth of Massachusetts.
F. DELANO PUTNAM,
Assistant Attorney General of the Commonwealth of Massachusetts.

ALEXANDER LINCOLN,
Of Counsel.

INDEX.

	Page.
Reference to official report of opinion in the courts below	1
Concise statement of the grounds on which the jurisdiction of this court is invoked	2
Concise statement of the cases	5
Specifications of errors	7
The pertinent constitutional and statutory provisions	7
Argument	12
I. All that a patentee obtains by his patent is the right to exclude others from the use, manufacture, or sale of the process patented	12
A. A patent once granted is merely an intangible property interest of the patentee. The right to exclude alone is unique	13
B. The sole Federal purpose is accomplished when the patent is granted—viz., the promotion of science and the useful arts by obtaining from inventors a public announcement of their progressive achievements in exchange for the monopoly granted to them for a limited time	15
II. Neither the Federal purpose behind the patent powers given to Congress by the Constitution nor the patentee's right to exclude is hampered in any way by state taxation of the net income of the patentee computed upon a gross income in which is included patent royalties	17
A. Once a patent is granted, it is within the power of a State to legislate within a wide range of discretion with respect to the exercise of the patent rights and to the use and manufacture of patented articles; so long as no interference with the right to exclude takes place	19

Page.

B. In order that a property interest may be permitted to escape state taxation as a Federal instrumentality, it must appear that the interest in question bears some substantial and intimate relation to the continued operation of a Federal constitutional purpose. A patent is merely the reward given for the disclosure of an invented process by virtue of a contract with the Government which by its terms includes no provision that the reward or its avails shall be exempt from state taxation 22

C. The Massachusetts Income Tax Act in taxing the net business income of Rockwood, in whose gross income was included patent royalties, imposed no perceptible or appreciable hamper or burden upon the ability of the Federal government or any agent thereof to perform any Federal function 30

TABLE OF CASES CITED.

Ager v. Murray, 105 U.S. 126 21
Allen v. Riley, 203 U.S. 347 20, 29
American Mfg. Co. v. St. Louis, 250 U.S. 459 32
Bauer v. O'Donnell, 229 U.S. 1 14
Bloomer v. McQuewan, 14 How. 539 14
California v. Central Pacific R.R. Co., 127 U.S. 1 29
Campbell v. Haverhill, 155 U.S. 610 (approved in Louisiana & Western R.R. Co. v. Gardiner, 273 U.S. 280) 29
Chicago, Rock Island & Pacific Ry. Co. v. Perry, 259 U.S. 548 5
Choctaw & Gulf R.R. Co. v. Harrison, 235 U.S. 292 22, 25
Cissna v. Tennessee, 246 U.S. 289 5
Clallam County v. United States, 263 U.S. 341 23
Commonwealth v. Petty, 96 Ky. 452 29

Page.

Commonwealth v. Westinghouse Electric and Manufacturing Co., 151 Pa. 265 28
Crew Levick Co. v. Pennsylvania, 245 U.S. 292 32
Denning Wire & Fence Co. v. American Steel & Wire Co., 169 Fed. 793 16
Dyer v. Melrose, 197 Mass. 99; s.c. 215 U.S. 594 27
Emert v. Missouri, 156 U.S. 296 21
Farmers etc. Bank v. Minnesota, 232 U.S. 516 23
First National Bank v. Anderson, 269 U.S. 341 23
Gillespie v. Oklahoma, 257 U.S. 501 22, 25
Gillette v. Bate, 86 N.Y. 87 21
Grant v. Raymond, 6 Pet. 220 14
Hart v. Tax Commissioner, 240 Mass. 37 31
Home Savings Bank v. Des Moines, 205 U.S. 503 23
Indian Terr. etc. Oil Co. v. Oklahoma, 240 U.S. 522 22, 25
I.T.S. Rubber Co. v. Essex Rubber Co., 276 Fed. 478 16
Jaybird Mining Co. v. Weir, 271 U.S. 609 22, 25, 26
John Woods & Sons Co. v. Carl, 203 U.S. 358 20
Kendall v. Winsor, 21 How. 322 16
Luckett v. Delpark, Inc., 270 U.S. 496 21
Machine Co. v. Gage, 100 U.S. 676 21
Mallinckrodt Chemical Works v. St. Louis, 238 U.S. 41 5
May v. Buchanan County, 29 Fed. 469 29
McCulloch v. Maryland, 4 Wheat. 316 18, 23, 24
Metcalf & Eddy v. Mitchell, 269 U.S. 514 13, 34, 35
Miedreich v. Lauenstein, 232 U.S. 236 5
Miller v. Milwaukee, 272 U.S. 713 34
Missouri v. Bell Telephone Co., 23 Fed. 539 13
Motion Picture Patents Co. v. Universal Film Mfg. Co., 243 U.S. 502 15, 16
Myers v. United States, 272 U.S. 52 19
North Carolina R.R. Co. v. Zachary, 232 U.S. 248 5
Northwestern Mutual Life Insurance Co. v. Wisconsin, U.S. Supr. Ct., Oct. term, 1927, dec. Nov. 21, 1927 18, 23
O'Brien Worthen Co. v. Stempel, 209 Fed. 847 16

Page.
Opinion of the Justices, 220 Mass. 613 31
Ozan Lumber Co. v. Union County National Bank, 207 U.S. 251 21
Pacific Bank v. Robinson, 57 Cal. 520 21
Paper Bag Patent Case, 210 U.S. 405 14
Patterson v. Kentucky, 97 U.S. 501 19
Pennock v. Dialogue, 2 Pet. 1 16
People v. Assessors, 156 N.Y. 417 28, 29
Railroad Co. v. Peniston, 18 Wall. 5 24, 25, 26
Robinson, Ex Parte, 2 Bissell, 309 29
Rockwood v. Commissioner of Corporations, 257 Mass. 572 31
Shafer v. Carter, 252 U.S. 37 32, 34
Sheffield, In re, 64 Fed. 833 29
Smith v. Kansas City Title & Trust Co., 255 U.S. 180 23
St. Louis Southwestern Ry. Co. v. Arkansas, 235 U.S. 350 32
State v. Butler, 3 Lea, 223 29
Tax Commissioner v. Putnam, 227 Mass. 522 31
Underwood Typewriter Co. v. Chamberlain, 254 U.S. 113 34
United States Glue Co., v. Oak Creek, 247 U.S. 321 34
Webber v. Virginia, 103 U.S. 344 20, 26

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Farrand, The Records of the Federal Convention, vol. 2, pp. 321, 322, 325, 505, 509, 570, 595, 655 15n
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General Laws, c. 62, § 6, as amended by Stat. 1922, c. 329, § 1 10
Judicial Code, § 237 (b), as amended by Act of Feb. 13, 1928 (43 Stat. at L. 937) 4

Page.

Massachusetts Income Tax Law (General Laws, c. 62) 9
Revised Statutes, § 4883, as amended by 42 Stat. at L. 391 (Act of February 18, 1922) 8
Revised Statutes, § 4884 8
Revised Statutes, § 4888, as amended by the Act of March 3, 1915, 38 Stat. at L. 958 8
Stat. 1921, c. 376, § 1 9
Stat. 1922, c. 329, § 1 10
38 Stat. at L. 958 8
42 Stat. at L. 391 8
43 Stat. at L. 937 4
U.S. Const. art. I, § 8 7

In the
Supreme Court of the United States.

OCTOBER TERM, 1927.

No. 201.

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION OF THE COMMONWEALTH OF MASSACHUSETTS, *Petitioner,*

v.

GEORGE I. ROCKWOOD, *Respondent.*

No. 202.

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION OF THE COMMONWEALTH OF MASSACHUSETTS, *Petitioner,*

v.

GEORGE I. ROCKWOOD, *Respondent.*

BRIEF FOR THE PETITIONER.

REFERENCE TO OFFICIAL REPORT OF OPINIONS IN THE COURTS BELOW.

The opinion of the full bench of the Supreme Judicial Court of Massachusetts, being the highest court of that State, will be found officially reported in 257 Massachusetts Reports, 572. It is printed in full on pages 36 to 39, inclusive, of the record.

The decision of *McLaughlin*, J., in the Superior Court of Massachusetts appears on pages 28 to 32, inclusive, of the record.

CONCISE STATEMENT OF THE GROUNDS ON WHICH THE JURISDICTION OF THIS COURT IS INVOKED.

1. The date of the judgments or final orders to be reviewed was December 27, 1926 (R. 39, 40). These orders were entered at the direction of *McLaughlin*, J., after the Supreme Judicial Court had, on November 27, 1926, by its rescript, overruled Long's exceptions (R. 35, 36).

2. The specific claims advanced, and rulings made, in the Superior and Supreme Judicial Courts of Massachusetts which are relied upon as the basis of this court's jurisdiction are as follows:

Rockwood, the taxpayer, in his petitions for abatements of his taxes, claimed (R. 5, 19) that the royalties received by him from United States patents were not taxable by Massachusetts under its income tax law. In both petitions these allegations were contained in paragraph 7 (a), and in each case they were expressly denied by the Commonwealth (R. 7, 20-21). At the trial before *McLaughlin*, J., in the Superior Court the Commonwealth requested the court to rule, in each case (R. 1, 15), that "Income from royalties received for the use of patents issued by the United States to the taxpayer upon inventions made by him is taxable as business income under G.L., c. 62, §5 (b), as amended." Judge *McLaughlin*, in his findings and rulings in both cases (R. 28-32, incl.), said (at pp. 29-30): "The first and principal question which arises is whether the complainant was taxable on his income for royalties, . . . It seems to be generally held . . . that it is not competent for the states to tax patent rights conferred by the United States. It would seem doubtful, therefore, whether they

can tax the income which a patentee or his assignee derives directly from leasing to others the right to manufacture under his patent. . . . Whatever the correct view may be in this respect, I find and rule on the findings of the commissioner that in this case [meaning thereby both cases] the income from the royalties was not income from business, and . . . was not taxable"; and further on in his decision he decided that in the several cases the taxpayer was entitled to abatements of $671 and $756.95, each with interest (R. 32). The Commonwealth duly excepted in each case (R. 2-3, 16-17) to the rulings made and to the court's failure to give the rulings requested. These exceptions were later duly argued before the Supreme Judicial Court, which, speaking through *Carroll,* J., used the following language:

> "In these two complaints the decisive question is the right of the Commonwealth to tax the income received from royalties for the use of patents issued by the United States [R. 36]. . . . A patent right itself is not taxable by a State. . . . As a State cannot tax the patent, it cannot tax the royalties received from its use. What the State cannot do directly it cannot accomplish in an indirect way. . . . A tax upon the income of property is in reality a tax upon the property itself [R. 37]. . . . But the tax levied on the royalties in the cases at bar was in effect a tax on the patent itself. It was a property tax . . . and was beyond the power of the State . . . As the income from royalties on the patents issued by the United States was not taxable the exceptions of the respondent are overruled. It becomes unnecessary, therefore, to consider the other questions argued by the complainant and respondent. In each case the entry must be: *Exceptions overruled*" (R. 38).

3. Jurisdiction of this court is invoked under JUDICIAL CODE, §237 (b), as amended by the Act of February 13, 1925 (43 STAT. AT L. 937), which is as follows:

> "It shall be competent for the Supreme Court, by certiorari, to require that there be certified to it for review and determination, with the same power and authority and with like effect as if brought up by writ of error, any cause wherein a final judgment or decree has been rendered or passed by the highest court of a State in which a decision could be had where is drawn in question the validity of a treaty or statute of the United States; or where is drawn in question the validity of a statute of any State on the ground of its being repugnant to the Constitution, treaties, or laws of the United States; or where any title, right, privilege, or immunity is specially set up or claimed by either party under the Constitution, or any treaty or statute of, or commission held or authority exercised under, the United States; and the power to review under this paragraph may be exercised as well where the Federal claim is sustained as where it is denied. . . ."

4. This court has already granted the Commonwealth's petitions for writs of *certiorari* in these cases, and we assume we need not further argue the question of whether or not these cases are properly before this court. It is true that Judge *McLaughlin,* in the trial court, did not expressly decide whether royalties from patents granted by the United States were exempted by virtue of the Constitution and laws of the United States from taxation by a State under its income tax statute. The question of such exemption was raised, however, in the taxpayer's complaints; the exemption was denied in the Commonwealth's answers; the Commonwealth requested the trial judge to rule that there was no such exemption and excepted to the

trial court's failure so to rule; that exception was argued by both parties in the highest court of the Commonwealth; and that court, as we have shown above, based its entire decision of the cases on that question alone. It is well settled that this court has jurisdiction to review the decision of a state court where the highest court of that State decides a material Federal question, apparently deeming the decision of that question necessary to the decision of the case before it. Here the Supreme Judicial Court of Massachusetts treated the Federal question as necessarily involved, and actually passed upon the Federal question raised as to the validity of the application of the state income tax statute to patent royalties, basing its whole decision upon the determination of that question. When the highest court of a State decides a Federal question, apparently deeming that decision necessary to the decision of a case, this court will review it.

Chicago, Rock Island & Pacific Ry. Co. v. *Perry,* 259 U.S. 548, 550-552.

Cissna v. *Tennessee,* 246 U.S. 289, 293-294.

Miedreich v. *Lauenstein,* 232 U.S. 236, 242-243.

North Carolina R.R. Co. v. *Zachary,* 232 U.S. 248, 257.

Mallinckrodt Chemical Works v. *St. Louis,* 238 U.S. 41, 49.

CONCISE STATEMENT OF THE CASES.

Rockwood, respondent herein, a citizen and inhabitant of Massachusetts (R. 3, bottom), brought actions at law in the Superior Court of Massachusetts against Long, petitioner herein, the State Commissioner of Taxation, seeking an abatement of certain state income taxes paid by Rockwood on his income for the calendar years 1921 and 1922 (R. 3, 17), primarily on the ground that said taxes were assessed on income received by Rockwood from a Massa-

chusetts corporation named the Rockwood Sprinkler Company (of which he was the president, treasurer, and principal stockholder) (R. 10 and 23, par. 9. of Commissioner's report), in the form of royalties for the use of patents issued to him by the United States, which royalties, he claimed, were not subject to taxation by the State [R. 5, par. (a); R. 19, par. (a)]. The Superior Court granted Rockwood an abatement in each case (R. 32). Long took the cases by bills of exceptions to the full bench of the Supreme Judicial Court of Massachusetts (R. 1, 15), which court overruled his exceptions on the sole ground that as a State cannot tax a patent right it cannot tax royalties received from the use of a patent right. The opinion by *Carroll*, J., will be found in full on pages 36-39 of the record. Thereafter judgments in Rockwood's favor were entered in the Superior Court (R. 39, 40). Long now petitions this honorable court for writs of *certiorari* to review those judgments.

The only substantial difference between the two cases is that in No. 201 the royalties were actually paid to Rockwood during the tax year of 1921 (R. 9, par. 6 of Commissioner's report), whereas in the tax year of 1922 Rockwood was credited with certain royalties on the books of the Rockwood Sprinkler Company, but they were not actually paid to him in that year (R. 22-23, par. 6 of Commissioner's report; R. 24, par. 9 of Commissioner's report; R. 25, par. 11 of Commissioner's report). All questions as to whether or not royalties paid or credited to Rockwood under the circumstances shown in these cases constituted income, as income is defined in the Massachusetts income tax statute, and whether royalties credited were the equivalent, for tax purposes, of royalties received, have been made immaterial in view of the ground taken by the State Supreme Judicial Court in its opinion. In that opinion (R. 36-38) that court treats the royalties as income (twice calling them by that name, R. 36, bottom, and R. 38, bot-

tom), but declares them non-taxable by the State because "the tax levied on the royalties in the cases at bar was in effect a tax on the patent itself . . . and was beyond the power of the State" (R. 38, end of first paragraph), and expressly says (R. 38, bottom): "It becomes unnecessary, therefore, to consider the other questions argued" by the parties.

SPECIFICATIONS OF ERRORS.

The petitioner makes the following specifications of errors, to wit:

The Superior Court judge erred in refusing to give petitioner Long's requested ruling No. 1 in each case (R. 1, 15), which requested ruling read as follows:

> "1. Income from royalties received for the use of patents issued by the United States to the taxpayer upon inventions made by him is taxable as business income under G.L., c. 62, §5 (b), as amended."

The Supreme Judicial Court erred in overruling the petitioner's exceptions (R. 38, bottom) and in deciding (R. 36-38) that, by virtue of the provisions of the Constitution of the United States, royalties received by a citizen of Massachusetts for the use of patents issued by the United States were not subject to taxation by that State under its general income tax statute, because such taxation "was beyond the power of the State" (R. 38, middle).

THE PERTINENT CONSTITUTIONAL AND STATUTORY PROVISIONS.

U.S. Const. art. I, §8, so far as material, is as follows:

> "The congress shall have power . . . to promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries; . . .

and to make all laws which shall be necessary and proper for carrying into execution the foregoing powers . . ."

REVISED STATUTES, §4883, as finally amended by 42 STAT. AT L. 391 (Act of February 18, 1922), is as follows:

"All patents shall be issued in the name of the United States of America under the seal of the Patent Office, and shall either be signed by the Commissioner of Patents or have his name printed thereon and attested by an Assistant Commissioner of Patents or by one of the law examiners duly designated by the commissioner, and shall be recorded, together with the specifications, in the Patent Office in books to be kept for that purpose."

REVISED STATUTES, §4884, is as follows:

"Every patent shall contain a short title or description of the invention or discovery, correctly indicating its nature and design, and a grant to the patentee, his heirs or assigns, for the term of seventeen years, of the exclusive right to make, use and vend the invention or discovery throughout the United States, and the Territories thereof, referring to the specifications for the particulars thereof. A copy of the specification and drawings shall be annexed to the patent and be a part thereof."

REVISED STATUTES, §4888, as amended by the Act of March 3, 1915, 38 STAT. AT L. 958, is as follows:

"Before any inventor or discoverer shall receive a patent for his invention or discovery, he shall make application therefor in writing, to the Commissioner of Patents, and shall file in the Patent Office a written description of the same, and of the manner and process

of making, constructing, compounding, and using it, in such full, clear, concise, and exact terms as to enable any person skilled in the art or science to which it appertains, or with which it is most nearly connected, to make, construct, compound, and use the same; and in case of a machine, he shall explain the principle thereof, and the best mode in which he has contemplated applying that principle, so as to distinguish it from other inventions; and he shall particularly point out and distinctly claim the part, improvement, or combination which he claims as his invention or discovery. The specification and claim shall be signed by the inventor."

Those portions of the Massachusetts Income Tax Law (GENERAL LAWS, c. 62, with amendments which affect these cases) here material are as follows:

GENERAL LAWS, c. 62, §5, as amended by STAT. 1921, c. 376, §1, is as follows:

"Income of the following classes received by any inhabitant of the commonwealth during the preceding calendar year shall be taxed as follows:

"(*a*) Income from an annuity shall be taxed at the rate of one and one half per cent per annum. . . .

"(*b*) The excess over two thousand dollars of the income, as defined in section six, derived from professions, employments, trade or business shall be taxed at the rate of one and one half per cent per annum. In determining such income the rental value of living quarters furnished any individual as part of his compensation shall be included. The wages and salaries of employees and officers of the United States government shall not be taxed. Retirement allowances, however described, from the commonwealth or any county, city, town or district thereof, or from any person, if not exempt by law, and interest received in the course

of business by persons loaning money as a business upon the pawn or pledge of tangible personal property, shall be taxed under this subsection.

"(*c*) The excess of the gains over the losses received by the taxpayer from purchases or sales of intangible personal property . . . shall be taxed at the rate of three per cent per annum. . . ."

GENERAL LAWS, c. 62, §6, as amended by STAT. 1922, c. 329, §1, is as follows:

"Income taxable under subsection (*b*) of section five shall be the gross income from the profession, employment, trade or business, in the year for which the income is computed, not including income exempt from taxation under this chapter or taxable hereunder otherwise than under said subsection (*b*), but including gains from the sale of capital assets, other than intangible personal property, employed therein; less the following deductions:

"(*a*) Expenses paid within the year in the profession, employment, trade or business, including the cost of ordinary repairs but not including personal or family expenses; . . .

"(*b*) A reasonable allowance for depreciation and obsolescence of property within such year, and for depletion within the year of wasting assets, except such ships and vessels as are described in section eight of chapter fifty-nine, owned by the person taxed and used in the profession, employment, trade or business; provided, that with the approval of the commissioner a taxpayer may, in lieu of the aforesaid allowance for depreciation and obsolescence, be allowed to deduct actual expenses of replacement of capital and extraordinary repairs, and with such approval may in any year defer such deductions in whole or in part to one or more subsequent years.

"(*c*) All taxes paid within the year to the United States or any other nation, or to any state, county, city, town or district, in respect of the profession, employment, trade or business, or the property held or used in connection therewith, but not including assessments for betterments.

"(*d*) Interest paid within the year on indebtedness of the person taxed incurred in connection with his profession, employment, trade or business; but no interest allowed as a deduction under section two shall also be allowed under this section.

"(*e*) Losses from the sale within the year of capital assets other than intangible personal property, and losses of capital assets other than stock in trade sustained within the year by fire, theft or other casualty, or amounts paid within the year on account of claims in law or equity incurred in connection with the profession, employment, trade or business, when such losses or amounts paid are not compensated for by insurance or otherwise.

"(*f*) The amount of any debts receivable arising from the conduct of the profession, employment, trade or business subsequent to December thirty-first, nineteen hundred and fifteen, determined by the person taxed to be worthless and actually charged off during the year; but no debts receivable shall be so charged off and deducted, unless they have previously been included as income in a return made under this chapter or corresponding provisions of earlier laws.

"(*g*) An amount equal to five per cent of the assessed value, less the amount of all mortgages thereon, of the stock in trade and other tangible property, real and personal, except such ships and vessels as are described in section eight of chapter fifty-nine, owned by the person taxed and used or employed in the profession, employment, trade or business within or

without the commonwealth, on the day as of which such property is assessed in the year for which the income is computed. In case any such stock in trade or other tangible property located without the commonwealth is taxed in respect of its income, and not in respect of its capital value, by the taxing district where located in such year, the commissioner may determine its value in any other manner, and may allow a deduction of an amount equal to five per cent of the value so determined.

"(*h*) The sum of five hundred dollars for a husband or wife with whom the taxpayer lives, and the sum of two hundred and fifty dollars for each child under the age of eighteen, or parent entirely dependent on the taxpayer for support. The aforesaid deduction shall not be allowed to both husband and wife, but may be allowed to either as they shall mutually agree, or shall be prorated between them in proportion to the net income of each in excess of two thousand dollars."

ARGUMENT.

I.

All that a Patentee Obtains by his Patent is the Right to Exclude Others from the Use, Manufacture, or Sale of the Process Patented.

In this case the determination of the true nature of a patent right will decide whether or not the patent right has such attributes as will exempt it and the proceeds of its use from state taxation under "the decisions holding that the very nature of our constitutional system of dual sovereign governments is such as impliedly to prohibit the federal government from taxing the instrumentalities of a state government, and in a similar manner to limit the power of the states to tax the instrumentalities of the

federal government" (*Metcalf & Eddy* v. *Mitchell*, 269 U.S. 514, 521).

A. A Patent Once Granted is Merely an Intangible Property Interest of the Patentee. The Right to Exclude Alone is Unique.

An analysis of the authorities reveals slight warrant for any peculiar differentiation of interests in patent rights from the interests of the holders of rights in other types of property. The words of Mr. Justice *Brewer* in an oral opinion given while a judge of the Circuit Court (E.D. Missouri) are apt:

> "There is no peculiar sanctity hovering over or attaching to the ownership of a patent. It is simply a property right, to be protected as such."
>
> *Missouri* v. *Bell Telephone Co.*, 23 Fed. 539, 540.

No question of taxation was involved in that case, but in many respects Mr. Justice *Brewer's* statement is true, we submit, for purposes of taxation.

A patent is a grant to an inventor by the Federal government of the privilege of excluding others from making, using, or vending a new discovery for seventeen years. The inventor had at common law the right to make, use, and sell anything that he might have invented. All that he gets from the United States when he obtains a patent is the *exclusive* right to make, use, and sell the patented article. This conclusion was reached early in our judicial history.

> ". . . and it cannot be doubted that the settled purpose of the United States has ever been, and continues to be, to confer on the authors of useful inventions an exclusive right in their inventions for the time mentioned in their patent. It is the reward stipulated for

the advantages derived by the public for the exertions of the individual, and is intended as a stimulus to those exertions. . . . The full benefit of the discovery, after its enjoyment by the discoverer for fourteen years, is preserved, and for his exclusive enjoyment of it during that time the public faith is pledged."

Marshall, C.J., in *Grant* v. *Raymond,* 6 Pet. 220, 241-242.

See also:

"The franchise which the patent grants, consists altogether in the right to exclude every one from making, using, or vending the thing patented, without the permission of the patentee. This is all he obtains by the patent."

Taney, C.J., in *Bloomer* v. *McQuewan,* 14 How. 539, 549.

The later decisions are entirely consistent:

"The patent law is the execution of a policy having its first expression in the Constitution, and it may be supposed that all that was deemed necessary to accomplish and safeguard it must have been studied and provided for. It is worthy of note that all that has been deemed necessary for that purpose, through the experience of years, has been to provide for an exclusive right to inventors to make, use and vend their inventions."

Paper Bag Patent Case, 210 U.S. 405, 423.

"In the exclusive rights to make, use and vend, fairly construed, with a view to making the purpose of Congress effectual, reside the extent of the patent monopoly under the statutes of the United States."

Bauer v. *O'Donnell,* 229 U.S. 1, 11.

"It has long been settled that the patentee receives nothing from the law which he did not have before, and that the only effect of his patent is to restrain others from manufacturing, using or selling that which he has invented. The patent law simply protects him in the monopoly of that which he has invented and has described in the claims of his patent."

Motion Picture Patents Co. v. *Universal Film Mfg. Co.*, 243 U.S. 502, 510.

B. The Sole Federal Purpose is Accomplished when the Patent is Granted—viz., the Promotion of Science and the Useful Arts by Obtaining from Inventors a Public Announcement of their Progressive Achievements in Exchange for the Monopoly Granted to them for a Limited Time.

The sole Federal purpose is amply described in the constitutional grant of power to Congress (art. I, §8, quoted, *supra*, p. 7). The method by which Congress is empowered to carry out the Federal purpose is also set out explicitly in the Constitution. It is perhaps significant that this is the only power granted to Congress in section 8 of article I, in which the method of carrying out the Federal function is stipulated carefully. It is at least arguable that the grant of exclusive rights alone is the one method by which Congress may (except in the proper exercise of some other power) promote science and the useful arts. Unfortunately the reports of the Constitutional Convention are meagre with respect to the patent power.[1]

A patent has been described in some of the inferior Federal courts as a contract between the inventor and the Gov-

[1] See FARRAND, THE RECORDS OF THE FEDERAL CONVENTION, vol. 2, pp. 321, 322, 325, 505, 509, 570, 595, 655. But slight attention seems to have been devoted to the matter, and it apparently aroused no controversial discussion. As for the FEDERALIST, the issue for January 25, 1788, contains the only reference to this power which has come to our attention. It is in no way of value in this discussion.

ernment, whereby, in consideration of the inventor's making his discovery public, the Government grants him a monopoly for a specified time.

> *Denning Wire & Fence Co.* v. *American Steel & Wire Co.*, 169 Fed. 793, 799.
>
> *O'Brien Worthen Co.* v. *Stempel*, 209 Fed. 847, 852.
>
> *I. T. S. Rubber Co.* v. *Essex Rubber Co.*, 276 Fed. 478.

And the reason why the Government makes this contract with an inventor and grants him his exclusive privilege has been many times stated by this court.

In *Pennock* v. *Dialogue*, 2 Pet. 1, 19, Mr. Justice *Story* said:

> "While one great object was, by holding out a reasonable reward to inventors and giving them an exclusive right to their inventions for a limited period, to stimulate the efforts of genius, the main object was 'to promote the progress of science and useful arts;' and this could be done best by giving the public at large a right to make, construct, use, and vend the thing invented, at as early a period as possible, having a due regard to the rights of the inventor."

And in *Kendall* v. *Winsor*, 21 How. 322, 327-328, Mr. Justice *Daniel* said:

> "It is undeniably true, that the limited and temporary monopoly granted to inventors was never designed for their exclusive profit or advantage; the benefit to the public or community at large was another and doubtless the primary object in granting and securing that monopoly."

And in *Motion Picture Patents Co.* v. *Universal Film Mfg. Co.*, 243 U.S. 502, 511, Mr. Justice *Clarke* said:

> ". . . this court has consistently held that the primary purpose of our patent laws is not the creation of private fortunes for the owners of patents but is 'to promote the progress of science and useful arts'."

We come, then, to the conclusion that a patent is a grant by the Government to an inventor of an exclusive right, not for the primary purpose of making money for him, but to benefit the public by securing, in the patent office, a disclosure of new and useful inventions, which, at the end of seventeen years, may be made or used freely by the public. In so far as the pocketbook of any individual inventor is involved the Government is not concerned to see to it that his gains from his invention shall not be reduced by taxation, but only to protect the exclusiveness of his right. The Massachusetts tax statute cannot be said in any manner to militate against the right to exclude. Therefore, if the statute is to fail, it must be on some other ground. And the only ground suggested is that patents are on the same footing as certain so-called "Federal instrumentalities" or "Federal agencies" which are so thoroughly under the protection of the Federal Constitution that even a state tax on the net income derived from their activities is invalid as a hamper on the powers and activities of the Federal government.

II.

NEITHER THE FEDERAL PURPOSE BEHIND THE PATENT POWERS GIVEN TO CONGRESS BY THE CONSTITUTION NOR THE PATENTEE'S RIGHT TO EXCLUDE IS HAMPERED IN ANY WAY BY STATE TAXATION OF THE NET INCOME OF THE PATENTEE COMPUTED UPON A GROSS INCOME IN WHICH IS INCLUDED PATENT ROYALTIES.

In considering whether or not a patent itself or the net income from a patent is so clothed with a Federal constitutional or governmental purpose that state taxation can-

not touch it, it is necessary to examine two lines of cases: The first group of decisions deals with the power of a State to legislate for tax purposes and otherwise with respect to dealings by patentees with their franchises and rights and with patented articles. The second line of authorities is that which began with *McCulloch* v. *Maryland,* 4 Wheat. 316, and the latest instance of which is *Northwestern Mutual Life Insurance Co.* v. *Wisconsin,* U.S. Supr. Ct., Oct. term, 1927, dec. Nov. 21, 1927, dealing with the implied prohibition contained in the Constitution of state taxation of Federal governmental functions. The first group of cases is useful to us because the decisions show, we submit, that the States may deal with patents, patent rights, and patented articles in a manner not compatible with regulation of a true Federal instrumentality. By an examination of those of the second group of cases here most pertinent, we contend that it becomes apparent that a patent once granted is in no way a Federal governmental agency or instrumentality within the meaning of the decisions. The question of whether or not States may hamper Federal activities or agencies or instrumentalities has been constantly before this court in an infinite variety of forms since 1819, but never yet, so far as we can discover, has this court expressly decided that a patent is a Federal instrumentality or agency to a degree which renders it, or royalties or net income derived from it, immune from state taxation. It is true that Chief Justice *Marshall,* in *McCulloch* v. *Maryland, supra,* at page 432, used the following language:

> "If the States may tax one instrument, employed by the government in the execution of its powers, they may tax any and every other instrument. They may tax the mail; they may tax the mint; they may tax patent rights; they may tax the papers of the custom house; they may tax judicial process; they may tax all

the means employed by the government, to an excess which would defeat all the ends of government. This was not intended by the American people."

While it may perhaps be deemed presumptuous for counsel even to intimate that the great chief justice was guilty of drawing somewhat hastily an unwarranted analogy when he classified patent rights with the Bank of the United States, and with the United States mint, mail, and judicial process, yet it is apparent that in this *dictum* the chief justice went beyond the exigencies of the case then actually before him, and we contend that in that classification he was in error. We feel fortified in taking this attitude by the remarks of the majority of this court in *Myers* v. *United States*, 272 U.S. 52, at p. 142.

A. Once a Patent is Granted, it is within the Power of a State to Legislate within a Wide Range of Discretion with Respect to the Exercise of the Patent Rights and to the Use and Manufacture of Patented Articles; so Long as No Interference with the Right to Exclude Takes Place.

There is so little sanctity hovering over or attaching to a patent that it is now, and has been for a long time, the law that a State may, in the exercise of its police power, prohibit the sale of articles which fail to measure up to the reasonable standards of the state statutes (and punish the seller in the criminal courts) even though the seller has a patent giving him the exclusive right to sell the article.

Patterson v. *Kentucky*, 97 U.S. 501.

Nor is a patentee, by virtue of his patent, entitled to sell in any State the articles manufactured under the patent free from the operation of a statute of that State imposing a license tax on such selling. Neither are such manufac-

tured articles exempt from state tax statutes because made under a patented process.

Webber v. *Virginia,* 103 U.S. 344.

In that case this court, speaking through Mr. Justice *Field,* said, at page 347:

> "And the right conferred by the patent laws of the United States to inventors to sell their inventions and discoveries does not take the tangible property, in which the invention or discovery may be exhibited or carried into effect, from the operation of the tax and license laws of the State."

It has been held that a patent is not so beyond the power of the States that the latter may not, by statute, attach onerous conditions to the assignment of the patent and dealings in connection therewith. A State may, by a statute expressly naming patent rights, and dealing only with patent rights, lawfully provide that no person shall sell any such right within the State without first filing in the office of a local clerk of court a copy of the letters patent duly authenticated, accompanied by an affidavit, taken by the clerk, that the letters patent are genuine and unrevoked and that he has authority to sell the right so patented; and further that any such seller who takes a written obligation as part of the consideration of such sale shall insert in the body of such obligation the words "Given for a patent right"; and that any person selling patent rights in violation of the statute may be proceeded against criminally for a misdemeanor and also shall be civilly liable in damages.

Allen v. *Riley,* 203 U.S. 347.
John Woods & Sons Co. v. *Carl,* 203 U.S. 358.

And a somewhat similar state statute making a negotiable instrument void unless it contains a statement on its

face that it was "executed in consideration of a patented machine" is constitutional.

Ozan Lumber Co. v. *Union County National Bank,* 207 U.S. 251.

Such immunity as a patent may have does not protect it from being reached by a bill in equity in a court of appropriate jurisdiction, and sold under an order of such court, at the suit of a creditor of the owner of the patent, whether the suit be in a Federal court—

Ager v. *Murray,* 105 U.S. 126—

or a state court—

Gillett v. *Bate,* 86 N.Y. 87.
Pacific Bank v. *Robinson,* 57 Cal. 520.

A patent, and royalties payable for the use thereof, are so little under the peculiar protection of the Federal Constitution and laws that, if Mr. Rockwood had had to sue his corporation for the royalties, he could not have brought his suit in a Federal court, as it would not have been one arising under the patent laws of the United States.

See *Luckett* v. *Delpark, Inc.,* 270 U.S. 496, 502, and cases there cited.

It is the law that a tax for a license to sell goods is in effect a tax on the goods authorized to be sold.

Machine Co. v. *Gage,* 100 U.S. 676, 678.

Yet it is also the law that a State may exact a license fee from peddlers who peddle "patents, patent rights, patent or other medicines," and all other goods, wares, or merchandise, without violating the Federal Constitution.

Emert v. *Missouri,* 156 U.S. 296.

It will be seen from an examination of the authorities just above cited that a State may limit the usefulness of a patent privilege to an inventor in many very material ways without in any degree imposing a burden upon the Federal purpose of the promotion of science through revelation of scientific secrets or upon the privilege of exclusion given by the Federal government under constitutional authority in payment for the disclosure by the inventor. It is inconceivable that such material hampers could be placed upon the activities of any true Federal instrumentality, such as the mint or the postoffice. Cf. *Johnson* v. *Maryland*, 254 U.S. 51. Yet it will be urged upon this court, and it was decided by the state court, that a patent stands upon the same footing as the Federal agencies or instrumentalities which were drawn in question in this court in the following recent cases:

Choctaw & Gulf R.R. Co. v. *Harrison*, 235 U.S. 292.

Indian Terr. etc. Oil Co. v. *Oklahoma*, 240 U.S. 522.

Gillespie v. *Oklahoma*, 257 U.S. 501.

Jaybird Mining Co. v. *Weir*, 271 U.S. 609.

An examination of the cases dealing with the non-taxability of Federal agencies and instrumentalities by the States must be made, therefore, in order that it may be apparent that a patent or income from a patent differs from such instrumentalities in their respective relations to any Federal constitutional purpose.

B. In Order that a Property Interest may be Permitted to Escape State Taxation as a Federal Instrumentality, it must Appear that the Interest in Question Bears Some Substantial and Intimate Relation to the Continued Operation of a Federal Constitutional Purpose. A Patent

is Merely the Reward Given for the Disclosure of an Invented Process by Virtue of a Contract with the Government which by its Terms Includes No Provision that the Reward or its Avails shall be Exempt from State Taxation.

By far the greater number of cases dealing with the implied prohibition of the exercise of the States' taxing power with respect to Federal instrumentalities have dealt with the taxation by the State of property interests in active use in accomplishing a decided Federal purpose.

McCulloch v. *Maryland, supra,* p. 18 (the Bank of the United States).

Home Savings Bank v. *Des Moines,* 205 U.S. 503 (United States Government Bonds).

Farmers etc. Bank v. *Minnesota,* 232 U.S. 516 (Territorial Government Bonds).

Smith v. *Kansas City Title & Trust Co.,* 255 U.S. 180 (Federal Land Bank).

Clallam County v. *United States,* 263 U.S. 341 (Corporation, entirely controlled by Federal government, making airplane lumber).

First National Bank v. *Anderson,* 269 U.S. 341, 347 (National Banks).

Northwestern Mutual Life Ins. Co. v. *Wisconsin, supra,* p. 18 (United States Government Bonds).

The property interests which the States attempted to tax in the cases just cited, even where the holder of the interest was an individual, and not the Federal government, were clearly essential phases of the active execution of a Federal governmental function. A patent itself, on the other hand, is merely a compensation given for a disclosure which serves a Federal purpose, the privilege consisting only of the limited right to exclude others from the use of the process disclosed. Where the acts of giving

the patent, of making the disclosure, or of excluding others from the use of a process are not hampered, no Federal purpose is the subject of state interference. The patent itself as a privilege of value, once issued, forms part of the great mass of property in the community, as to which the Federal government is under an obligation to protect the patentee only to the extent of seeing that the patent succeeds in excluding others from the process involved (see cases cited, *supra*, pp. 13 to 17). The avails of the use of the patent here taxed (see this brief, *infra*, p. 30) have even more remote a connection with any Federal purpose than has the patent itself. Not only do they depend in large part upon the merit of the process used, the ingenuity of the manufacturer employing the process, and the business acumen of the holder of the patent; but they are the result of the operation of a business which (except in rare instances) has no Federal aspect and which is in no sense operated as a governmental function. Clearly the Federal government (taking the facts of the case at bar) is neither in the business of leasing sprinkler patents nor engaged in manufacturing sprinklers. It can hardly be said that the patentee is in any sense an agent of the Federal government, yet even if he were such an agent, he could be taxed with respect to the property employed by him as such an agent so long as no governmental function performed by him was taxed.

Railroad Co. v. *Peniston*, 18 Wall. 5, 36.

That decision (at p. 30) so clearly supports the jurisdiction of a State under the Constitution to lay a "tax which remotely affects the efficient exercise of a Federal power" that it would be difficult to see how it could be contended that taxation of a patent or of the avails of a patent in any way hampered the Federal government in promoting science and the useful arts by the process of exclusion (the only constitutional method available to the Federal gov-

ernment), were it not for the dictum in *McCulloch* v. *Maryland, supra,* discussed in this brief above at p. 18, and for the decisions in the Oklahoma tax cases where the Federal government's functions with respect to the protection of the Indians were held to be impeded by the state taxes there involved.

In *Choctaw & Gulf R.R. Co.* v. *Harrison, supra* (p. 22), this court held that a privilege tax could not be imposed upon a taxpayer which was engaged in operating Indian mines under Congressional authority as a Federal instrumentality—in effect as an agent of the Federal government. The decision is not inconsistent with *Railroad Co.* v. *Peniston, supra* (which was cited by the court with apparent approval), for in the *Choctaw* case it was not the property of the agent which was taxed, but the agency itself. The State was attempting to burden the governmental function of protecting the wards of the nation. The Massachusetts statute imposes no tax upon any Federal agency or function. If it comes within any constitutional prohibition, it does so by virtue of some indirect burden, for there is no direct tax impact upon the promotion of science and the useful arts. In *Indian etc. Oil Co.* v. *Oklahoma, supra* (p. 22), the incidence of the state tax was directly upon the lease creating the lessee a Federal agent or instrumentality. As in the *Choctaw* case, this directly burdened the agency, itself the governmental function. In the case at bar, the lease of the patents (by which Rockwood permitted the corporation created at his instigation to use the patented process) in no wise constituted the lessee a Federal agency. *Gillespie* v. *Oklahoma, supra* (p. 22), rested upon the ground that a tax upon the income from an oil lease which created the lessee a Federal agent to carry out a Federal governmental function was a tax upon the lease, itself the agency. It may be distinguished upon the same grounds. *Jaybird Mining Co.* v. *Weir, supra* (p. 22), held that an *ad valorem* tax upon the ore

mined by a lessee thus acting as a Federal agent, when imposed before the lessee's obligations to the wards of the nation had been adjusted and settled, was in substance and effect a direct tax upon the agency or Federal instrumentality measured by the value of the agency to the agent, and not a tax upon the property of the agent as property. This construction of the effect of the tax (adopted by the majority of the court) distinguishes the tax from the tax in *Railroad Co.* v. *Peniston, supra,* which was relied upon by Mr. Justice *Brandeis,* who, in his dissenting opinion, took the view that the tax was in its incidence a tax upon the property of the agent, and not a burden upon the agency. The tax in *Railroad Co.* v. *Peniston* was clearly more directly a burden upon a Federal function that the small, non-discriminatory tax upon Rockwood's net income in the case at bar, for in the *Peniston* case the railroad taxed was carrying out a Federal purpose, whereas Rockwood, once having revealed his invention to the world and received his reward, was engaged in no governmental service. He was for his private profit in the business of leasing sprinkler patents and (through a corporation which he controlled) manufacturing sprinklers.

If patents and the avails of their use are on the same footing as true Federal instrumentalities, the ore in the bins of the Jaybird Mining Company must differ mysteriously from the patented articles in the hands of the taxpayer involved in *Webber* v. *Virginia, supra* (p. 20), for the ore in the *Jaybird* case was held not to be taxable by Oklahoma, whereas the patented articles were held taxable by Virginia. If patents are on all fours with the Indian agencies, the produce of the patents should be on the same footing as the produce of the Indian lands and leases. Under the decisions of this court, they are not, because articles manufactured under a patent are taxable, whereas ore dug from Indian lands is not. Should it not follow that money earned in the form of royalties under a patent is taxable,

although money earned under an Indian lease is not? One distinction between patents and patent royalties on the one hand, and Indian leases and their rents on the other, obviously is that the United States has long been bound by treaties, by acts of Congress, and by every consideration of decency and moral responsibility to use every effort to preserve and protect the property of the Indians and to administer it to their best advantage, whereas the framers of the Constitution, and the various Congresses which have enacted the patent laws, never for one moment felt that the United States owed to inventors the duty of protecting them further than to secure to them an *exclusive* right for a brief period of years. Therefore we contend that any argument seeking to place patents on the same footing as the banks, the mint, the mail, and the judicial process of the United States is unsound.

It is difficult on principle to discern how the taxation of the net income of a taxpayer who has received patent royalties during the tax year imposes as great a burden upon the ability of any Federal agent to perform his duties or upon any Federal function as did the taxation of money received by Rear Admiral Dyer of the United States Navy by way of salary, taxed as money in the bank on the annual tax day.

> See *Dyer* v. *Melrose,* 197 Mass. 99; s.c. 215 U.S. 594.

We are aware, of course, that taxation of income involves a taxation whereby the ability of the taxpayer to pay is measured by the annual increments of wealth to him. Such taxation in a vague way has a more definite reference to the source from which the wealth came than taxation of a man which measures the ability of the taxpayer to pay by his whole property on a given day. From the point of view of the burden and effect of the tax upon the successful execution of any Federal purpose, it is impossible to

find any rational basis for saying that the tax on Rockwood's net income imposed more of a hamper upon the Federal promotion of science and the useful arts than the taxation of Admiral Dyer did upon the war preparations of the Government. We venture to suggest that the result reached by the Massachusetts court in the case at bar is one that would have amazed the members of the constitutional convention of 1787 and the members of the various Congresses that have legislated with reference to patents. We venture further to suggest that a decision by this court sustaining that result would come to all inventors and authors as a very great surprise. It means, if upheld, that every net dollar earned by inventors and authors, and every net dollar earned by the assignees of their patents and copyrights, in large part for labor and materials having a decided value apart from any exclusive feature granted by the United States, is pulled out from under the taxing powers of States which have income tax laws; that every net dollar coming into the treasuries of the great manufacturing corporations of this country which can be isolated as a dollar which came in as a patent royalty is so exempt; that every net dollar earned by the large publishing houses which have bought up copyrights from authors and which comes in as a result of those copyrights is so exempt. Was that what the constitutional convention intended when they adopted a phrase giving Congress power to grant limited exclusive rights to authors and inventors? Was that what the people understood that phrase to mean when they ratified the adoption of the Constitution? Such questions, it seems to us, answer themselves.

We are of course aware of certain decisions of state courts holding that a State may not impose a tax on patents or upon so much of the capital stock of a corporation as represents patents. We refer to *Commonwealth* v. *Westinghouse Electric and Manufacturing Co.*, 151 Pa. 265, and subsequent Pennsylvania decisions which have followed it,

and to *People* v. *Assessors*, 156 N.Y. 417, which has been followed in New York. Those cases fall into what we deem the error of considering patents on the same footing as the Federal franchise drawn in question in *California* v. *Central Pacific R.R. Co.*, 127 U.S. 1, and as the mails and the mint. In *People* v. *Assessors, supra*, the New York Court of Appeals apparently relies largely on *In re Sheffield*, 64 Fed. 833, *Ex Parte Robinson*, 2 Bissell, 309, 313, *May* v. *Buchanan County*, 29 Fed. 469, *Commonwealth* v. *Petty*, 96 Ky. 452, and *State* v. *Butler*, 3 Lea, 223. All those cases, except *May* v. *Buchanan County*, have been overruled by this court in *Allen* v. *Riley, supra;* and *May* v. *Buchanan County* has been overruled by this court in *Campbell* v. *Haverhill*, 155 U.S. 610 (approved in *Louisiana & Western R.R. Co.* v. *Gardiner*, 273 U.S. 280, 284).

In view of the long line of decisions and statements of this court (see *supra*, pp. 13 to 17) which when summarized virtually declare that all that the Constitution authorized Congress to do to promote science and the useful arts was to grant brief exclusive privileges to authors and inventors, and that, having made such grants, Congress had exhausted its powers, we feel that the Massachusetts court in this case and the other state courts in earlier cases have gone beyond even the spirit of the Constitution in reading into that document an implied exemption from state taxation of patents and royalties. Those courts have certainly gone farther than this court has ever gone by decision. We feel that we have shown that a patent is not in itself more than the reward for a disclosure of a scientific secret or process. Once granted it ceases to perform any Federal function and its use may be regulated by the States within a very broad range, inconsistent with any classification of a patent *per se* as a Federal instrumentality. If it be not a Federal instrumentality, the fact that a tax is imposed upon a patent or the proceeds of its use does not in and of itself render the tax invalid. It must be shown that the impact

of the tax in question is such as to hamper materially and not remotely the ability of the Federal government or of some agent of the Federal government to carry out a Federal governmental function. What, then, is the precise nature and effect of the tax in question?

C. The Massachusetts Income Tax Act in Taxing the Net Business Income of Rockwood, in whose Gross Income was Included Patent Royalties, Imposed No Perceptible or Appreciable Hamper or Burden upon the Ability of the Federal Government or Any Agent thereof to Perform Any Federal Function.

The Massachusetts statute imposes a tax on the net income derived by the taxpayer from professions, employments, trade, or business, the amount of said net income being arrived at by permitting the taxpayer to deduct from the gross income the sum of $2000; the expenses of the business paid within the year; a reasonable allowance for depreciation and obsolescence, and for depletion of wasting assets, or (in the alternative) actual expenses of replacement of capital and extraordinary repairs; all taxes paid within the year with respect to the business, excluding betterment taxes; interest paid within the year on indebtedness of the taxpayer in connection with the business; losses of capital assets within the year by fire or other casualty, or (in the alternative) amounts paid out within the year on uninsured claims incurred in connection with the business; debts receivable arising from the conduct of the business determined to be worthless and actually charged off during the year; an amount equal to five per cent of the assessed value (less mortgages) of the stock in trade and other tangible property used in the business; and the sum of $500 for wife, and the further sum of $250 for each child under eighteen years of age dependent on the taxpayer for support, the total for wife and children not to exceed $1000 (see *supra*, pp. 9-12).

The state court has held that the tax imposed on net income by this statute is a property tax.

Rockwood v. *Commissioner of Corporations,* 257 Mass. 572, 574 (R. 36, 38).
Hart v. *Tax Commissioner,* 240 Mass. 37, 39.
Tax Commissioner v. *Putnam,* 227 Mass. 522, 531-532.
Opinion of the Justices, 220 Mass. 613, 623-627.

It should be noted, however, that in the *Opinion of the Justices,* last above cited, the justices expressly declined to decide whether a tax on the income from professions, trades, or employment was a property tax (220 Mass. 613, 624-625); that in *Tax Commissioner* v. *Putnam,* 227 Mass. 522, the question of the precise nature of this tax on net business income was not involved; and that in *Hart* v. *Tax Commissioner,* 240 Mass. 37, the plaintiff's income was derived from personal property, and apparently not from business. It is, however, now settled so far as the Massachusetts courts are concerned that the personal income taxes collected by that State are property taxes. Even if the tax is in its essence a property tax, and, as construed by the Massachusetts court, a property tax on the patent in the hands of the patentee, it does not follow that such a tax burdens any Federal function. The Massachusetts court in the opinion below said (R. 38): "But the tax levied on the royalties in the case at bar was in effect a tax on the patent itself." If by that it meant that the tax on the patent necessarily burdened the Federal function of promoting science and the useful arts, we submit that the learned court was in error, and in error upon the decision of a purely Federal question—that of the burdening of a Federal purpose. While the general rule of this court has been, for a long time, that decisions of state courts putting a certain interpretation on local statutes are to be

deemed decisions of questions of state law, and so not reviewable here; yet in reaching a decision as to the "operation and effect" of taxes imposed by state statutes this court, while accepting the construction given to the statute by the state court, will, nevertheless, itself look into and pass upon the "practical operation and effect of the tax imposed." This rule has been many times stated by this court. It was forcibly stated by Mr. Justice *Pitney* in *Shaffer* v. *Carter*, 252 U.S. 37, 55, in the following language:

> "For, where the question is whether a state taxing law contravenes rights secured by that instrument [the Federal Constitution] the decision must depend not upon any mere question of form, construction, or definition, but upon the practical operation and effect of the tax imposed"—

and by the same justice in *Crew Levick Co.* v. *Pennsylvania*, 245 U.S. 292, 293, as follows:

> "As in other cases of this character, we accept the decision of the state court of last resort, respecting the proper construction of the statute, but are in duty bound to determine the questions raised under the Federal Constitution upon our own judgment of the actual operation and effect of the tax, irrespective of the form it bears or how it is characterized by the state courts."

See also *St. Louis Southwestern Ry. Co.* v. *Arkansas*, 235 U.S. 350, 362.

American Mfg. Co. v. *St. Louis*, 250 U.S. 459, 462-463.

While it may, in a sense, be true that a tax imposed upon royalties may be a tax upon the patents, yet we submit that it does not impose a burden in any such sense as to

render the tax invalid under the Constitution or laws of the United States. The tax is not even actually a tax upon the patent. It is upon the net business income of a business man a part of whose gross income consisted of royalties and the rest of whose gross income consisted of salaries from two corporations which he controlled and which used the patents and paid him for such use. It is a tax upon money coming into the taxpayer's pocket in the course of his business under ordinary commercial transactions, namely, contracts which he has made in the course of his business with relation to certain patents owned by him. It is, at the most, an exceedingly indirect "hamper" upon any activity with which Congress has to do. We submit that a state tax of one and one-half per cent on net income (where patent royalties are included in gross income) cannot in any sense be held to impose a direct and sensible burden upon the ability of the Federal government to obtain disclosure of inventions by a grant of a limited exclusive right to the invented process. The compelling reason for the patenting of an invention is the obtaining of a quasi-monopoly which has at once the double effect of preventing others from discovering and using the valuable processes invented and also of insuring that the original inventor will not lose the right to the process himself because some other person discovers his process (if the process be kept by the original inventor as a trade secret), patents it, and thus excludes the original inventor from its use. Tax exemption of the business to be conducted by aid of the patents cannot fairly be said to be the purpose of obtaining the patent, in view of the fact that, if an inventor refrains from patenting his invention and instead of so doing proceeds to use his invention without patenting it, and earns money by so doing, the State will tax him on those earnings and at the same time the inventor will be running the very imminent risk of losing his right to a patent entirely.

The cases holding that a tax upon the net income of a taxpayer part of whose gross income is derived from transactions in interstate commerce does not burden that commerce are here persuasive, if the view for which we contend be taken, viz., that patents once issued are not themselves Federal instrumentalities, but are merely compensation paid once for all to the patentee for his disclosure.

United States Glue Co. v. *Oak Creek,* 247 U.S. 321.

Underwood Typewriter Co. v. *Chamberlain,* 254 U.S. 113.

Shaffer v. *Carter,* 252 U.S. 37, 57.

The tax is not open to the objection (which was successfully raised in *Miller* v. *Milwaukee,* 272 U.S. 713) that it singles out patent royalties and discriminates against them. It says not a word about patent royalties. It deals only with business income—money left in the pockets of a business man, earned in the usual course of business, after he shall have deducted the expenses of doing business and certain other fair and equitable allowances. Nor is the tax statute in these cases aimed at Federal agencies with the covert purpose of taxing them under the guise of ordinary everyday taxation. It is aimed only at the net income of its inhabitants derived from their respective occupations. Much of the language used by Mr. Justice *Stone* in *Metcalf & Eddy* v. *Mitchell,* 269 U.S. 514, together with many of the views therein expressed by this court, is applicable to these cases. We quote:

> "But here the tax is imposed on the income of one who is neither an officer nor an employee of government and whose only relation to it is that of contract, under which there is an obligation to furnish service, for practical purposes not unlike a contract to sell and deliver a commodity. The tax is imposed without dis-

crimination upon income whether derived from services rendered to the state or services rendered to private individuals. In such a situation it cannot be said that the tax is imposed upon an agency of government in any technical sense, and the tax itself cannot be deemed to be an interference with government, or an impairment of the efficiency of its agencies in any substantial way."

While patents are created by the Government they are not controlled by it in the sense that the lessees were in the Indian land cases. They are contracts between the Government and the patentees, and all that the latter obtain is an *exclusive* right. When the Government assures *that* right to patentees it has done its whole duty toward them. We quote further from *Metcalf & Eddy* v. *Mitchell, supra,* at pages 523-524:

"In a broad sense, the taxing power of either government, even when exercised in a manner admittedly necessary and proper, unavoidably has some effect upon the other. The burden of federal taxation necessarily sets an economic limit to the practical operation of the taxing power of the states, and *vice versa.* Taxation by either the state or the federal government affects in some measure the cost of operation of the other.

"But neither government may destroy the other nor curtail in any substantial manner the exercise of its powers. Hence the limitation upon the taxing power of each, so far as it affects the other, must receive a practical construction which permits both to function with the minimum of interference each with the other; and that limitation cannot be so varied or extended as seriously to impair either the taxing power of the government imposing the tax (*South Carolina* v. *United States,* 199 U. S. 437, 461; *Flint* v.

Stone Tracy Co., supra, at 172,) or the appropriate exercise of the functions of the government affected by it. *Railroad Co.* v. *Peniston, supra,* 31'' (see *supra,* p. 24).

We contend that the judgment below should be reversed.

Respectfully submitted,

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1926.

No. [redacted] 201

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION OF THE COMMONWEALTH OF MASSACHUSETTS, PETITIONER,

v.

GEORGE I. ROCKWOOD, RESPONDENT.

OCTOBER TERM, 1926.

No. [redacted] 202

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION OF THE COMMONWEALTH OF MASSACHUSETTS, PETITIONER,

v.

GEORGE I. ROCKWOOD, RESPONDENT.

Petition for Writs of Certiorari to the Superior Court of the Commonwealth of Massachusetts for the County of Worcester.

BRIEF FOR RESPONDENT

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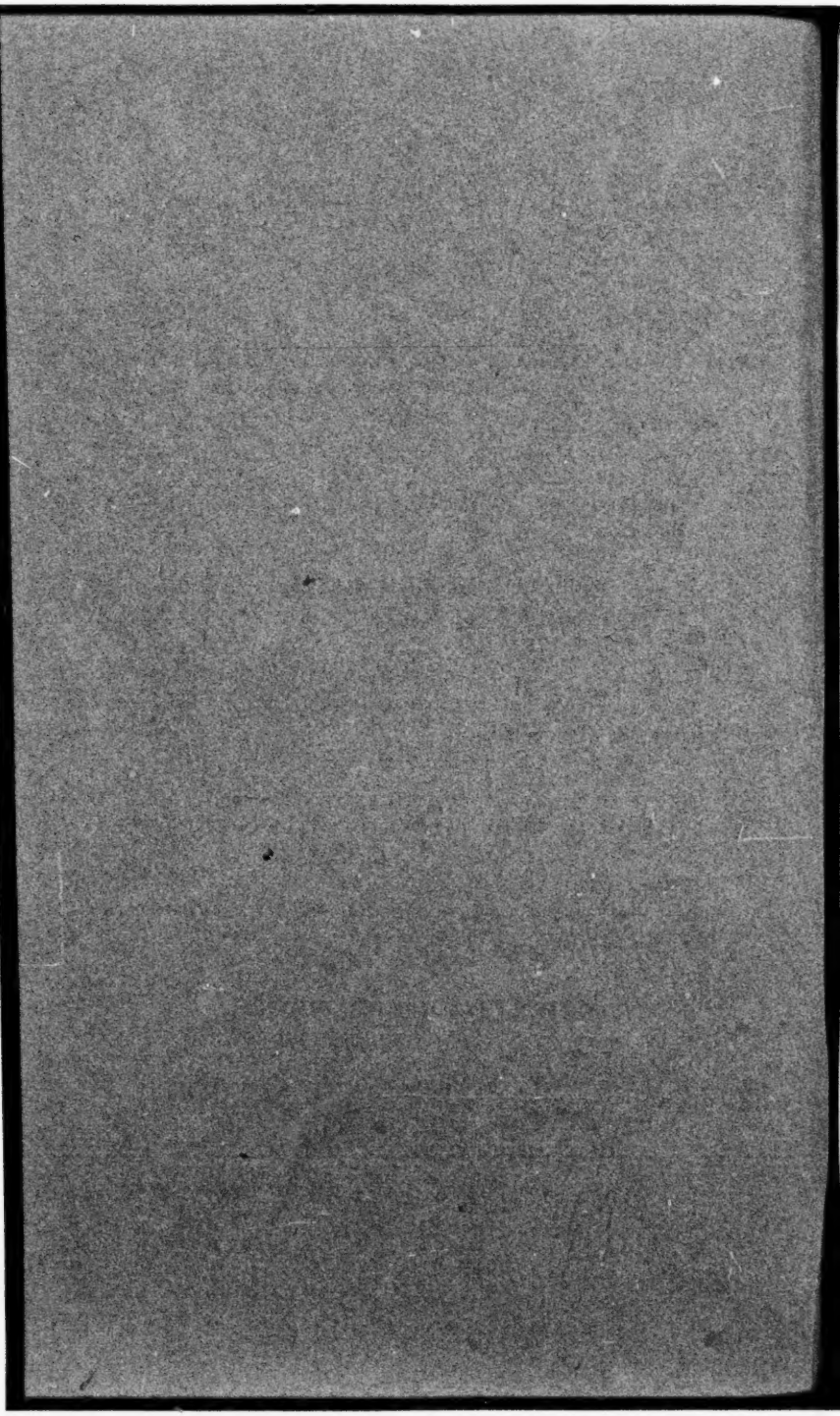

INDEX.

	Page
Brief of respondent	1
Short statement of the cases	1
Argument of respondent	3

Table of Cases Cited.

Choctaw & Gulf R. R. v. Harrison, 235 U. S., 292	8
Dorchy v. Kansas, 264 U. S., 286, 290	5
Farmers & Merchants Savings Bank v. Minnesota, 232 U. S., 516	8
Gatewood v. North Carolina, 203 U. S., 531, 541	5
Gillespie v. Oklahoma, 257 U. S., 501	8, 9
Hart v. Tax Commissioner, 240 Mass., 37, 39	4, 7
Hump Hairpin Co. v. Emmerson, 258 U. S., 290	8
Indian Oil Co. v. Oklahoma, 240 U. S., 522	8
Jaybird Mining Co. v. Weir, 271 U. S., 609, 613	8
Johnson v. Maryland, 254 U. S., 51, 56	8
Kennedy v. Tax Commissioner, Mass. Advance Sheets (decided June, 1926)	4
McCullough v. Maryland, 4 Wheat., 316, 432	6, 8
Maguire v. Tax Commissioner, 230 Mass., 503, 512	4
Opinion of the Justices, 193 Mass., 608, 609	6, 9
Opinion of the Justices, 220 Mass., 613, 624	4, 7
Patterson v. Kentucky, 97 U. S., 501	9
People v. Assessors, 156 N. Y., 417, 418	6
People v. Campbell, 138 N. Y., 543	9
Pollock v. Farmers Loan & Trust Co., 157 U. S., 429, 581	7
Shaffer v. Carter, 252 U. S., 37	8
Tax Commissioner v. Putnam, 227 Mass., 522, 531, 532	4
U. S. Glue Co. v. Oak Creek, 247 U. S., 321	8
Webber v. Virginia, 103 U. S., 344	6, 9

Table of Statutes Cited.

General Laws of Massachusetts, Chapter 62	4, 10
Judicial Code, Section 247, as amended by the Act of Congress of February 13, 1925	6
Revenue Act of 1926	10

Other Authorities Cited.

Revised Rules of the Supreme Court of the United States, Rule 35	6
Constitution of the United States, Article I, Section 8	8

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1926.

No. 993.

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION, PETITIONER,

v.

GEORGE I. ROCKWOOD, RESPONDENT.

OCTOBER TERM, 1926.

No. 994.

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION, PETITIONER,

v.

GEORGE I. ROCKWOOD, RESPONDENT.

BRIEF FOR RESPONDENT

Short Statement of the Cases.

The petition (including supporting brief) of the petitioner in these two cases contains a short and summary statement of the matter involved and the reasons relied on for the allowance of the writs (p. 2–5).

The jurisdiction of this court is invoked by the petitioner, Henry F. Long, Commissioner of Corporations

and Taxation of the Commonwealth of Massachusetts, represented by the Attorney General of said Commonwealth, to review on writs of certiorari decisions of the highest court of said Commonwealth. The decisions sought to be reviewed were in two proceedings brought in the State Courts by complainant (respondent herein) as a taxpayer under the provisions of Chapter 62 of the General Laws of Massachusetts, as amended, entitled "Taxation of Incomes", with a sub-title "Taxation of Income from Annuities, Professions, Employments, Trade And Business" (R. 3, 17).

The complainant, a resident of Massachusetts, in his two complaints alleged several contentions (R. 5, 19).

In each complaint was alleged

> "the patents granted * * * and the royalties therefrom received by complainant * * * are not taxable under said Chapter 62 (as amended), and there was error to include said royalties as subject to tax."

Also, in each complaint was alleged

> "the ownership of said patents and receipt of royalties * * * under the facts did not constitute income derived 'from professions, employments, trade or business' as defined under said Chapter 62 (as amended) and there was error to include royalties as subject to tax."

The Superior Court of the Commonwealth of Massachusetts for the County of Worcester, in the first case did find and rule" * * * that the income from

royalties was not income from business, and not being income from any kinds of 'intangible personal property' specified in the income tax law, was not taxable" (R. 30). A similar finding and ruling was made in the second case (R. 31). Because of these rulings and of the failure to rule the cases were taken by said Commissioner on exceptions before the full court of the Supreme Judicial Court of the Commonwealth of Massachusetts (R. 1–3, 15–17) and that court in its rescript or order overruled the exceptions and ordered the entry to that effect in the Superior Court (R. 35, 36). Thereafter on December 27, 1926, final orders were entered in the Superior Court, granting the abatements (R. 39, 40). In its statement of the grounds and reasons for its decision, it appears that the Supreme Judicial Court considered that the decisive question involved in the two complaints was "the right of the Commonwealth to tax the income received from royalties for the use of patents issued by the United States." (R. 36.)

The present petition is brought under the provisions of the Judicial Code, Section 237, as amended by the Act of Congress of February 13, 1925.

Argument.

The petitioner, Henry F. Long, as Commissioner of Corporations and Taxation of the Commonwealth of Massachusetts asks this Court to review a decision of the highest court of that Commonwealth, construing a peculiar local tax statute, the so-called Massachusetts Income Tax Act. This statute applies solely to residents of Massachusetts; it is not a statute of general application, but is limited to taxing income derived from certain designated sources or property only. The

rates of tax are not progressive but vary according to the nature of the income.

> *See General Laws of Massachusetts (1921), Chapter 62.*

The Supreme Judicial Court of the Commonwealth has declared and construed this tax as a tax on property. In the opinion of the Justices, 220 Mass. 613, 624, it was said

> "A tax upon the income of property is in reality a tax upon the property itself. Income derived from property is also property. Property by income produces its kind, that is, it produces property and not something different. It does not matter what name is employed. The character of the tax cannot be changed by calling it an excise and not a property tax. In its essence a tax upon income derived from property is a tax upon the property."

It is a tax upon property and is not a personal tax nor an excise tax.

> *Tax Commissioner v. Putnam*, 227 Mass. 522, 531, 532.
> *Maguire v. Tax Commissioner*, 230 Mass. 503, 512.
> *Hart v. Tax Commissioner*, 240 Mass. 37, 39.
> *Kennedy v. Tax Commissioner*, Mass. Advance Sheets (decided June, 1926).

No one contends that the states can tax patents issued by the United States without the consent of

Congress which consent has not been given. If the Commonwealth's statute, as construed by its highest court, levies a tax on property and the property involved is a United States Patent, it follows that the state cannot tax.

WHAT THE PETITIONER HERE SEEKS, IS THAT THIS COURT OVERRULE THE DECISION OF MASSACHUSETTS AND DECLARE THAT THE MASSACHUSETTS STATUTE IS NOT A TAX ON PROPERTY; BUT THIS COURT WILL NOT REVIEW THE DECISION OF THE HIGHEST COURT OF THE STATE AS TO THE SCOPE, CONSTRUCTION AND NATURE OF A LOCAL STATUTE.

Gatewood v. North Carolina, 203 U. S. 531, 541.
Dorchy v. Kansas, 264 U. S. 286, 290.

Upon the facts and the record the respondent herein submits that the petition for the two writs should be denied for these reasons:

(1) because the final judgments or decrees of the State court do not involve a decision:

(a) where is drawn in question the validity of a treaty or statute of the United States; or

(b) where is drawn in question the validity of a statute of any State on the ground of its being repugnant to the Constitution, treaties, or laws of the United States; or

(c) where any title, right, privilege, or immunity is specially set up or claimed by either party under the Constitution, or any treaty or statute of, or commission held or authority exercised under, the United States.

Section 237 (b) Judicial Code, as amended by the Act of February 13, 1925.

and/or

(2) because there are no special and important reasons for review on writs of certiorari that this Court, in the exercise of a sound judicial discretion, should consider.

Rule 35, Revised Rules of the Supreme Court of the United States.

I. Could the State under its Constitution and laws tax the royalties here in issue. That question the State Courts by their judgments or decrees answered in the negative. It was unnecessary for the State Courts to determine any other question raised.

As to this question, the State Courts held in these cases:

(a) Patents issued by the United States cannot be taxed by the States without the consent of Congress.

(1) This was conceded by the respondent as stated in the opinion of the Supreme Judicial Court (R. 37).

(2) The Supreme Court of the United States has so held, as stated in said opinion (R. 37), citing

Webber v. Virginia, 103 U. S. 344, 347.
McCullough v. State of Maryland, 4 Wheat. 316, 432.

See also

Opinion of the Justices, 193 Mass. 605, 608, 609.
People v. Assessors, 156 N. Y. 417, 418.

(b) A tax upon the income of property is in reality a tax upon the property itself (R. 37), citing.

Opinion of the Justices, 220 Mass. 613, 614.

(c) A tax levied on the royalties was in effect a tax on the patent itself and the tax levied was a property tax, and beyond the power of the State (R. 38), citing.

Hart vs. Tax Commissioner, 240 Mass. 37, 39.

As to this question this Court has, also, held that a tax on the rents from real estate was in effect a tax on the land itself.

Pollock v. Farmers Loan & Trust Company, 157 U. S. 429, 581.

II. On another question the State Supreme Judicial Court may have gone one step beyond the necessities of the cases. Although not necessary to sustain an order or decree abating the taxes assessed and levied, its opinion is to the effect that the Massachusetts Income tax laid upon income (royalties or use of patents) not only would be a tax upon the property right (and thus illegal) but such tax would have greater consequences in that it would defeat or impair the Federal purposes, and, granted the power to tax, it would be possible through its exercise to prevent, handicap or destroy the use of the patent right granted by the United States.

The Supreme Judicial Court in its opinion cites such cases as

Choctaw & Gulf R. R. v. Harrison, 235 U. S. 292.
Indian Oil Co. v. Oklahoma, 240 U. S. 522.
Gillespie v. Oklahoma, 257 U. S. 501.

It could have, also, relied upon such cases as

Jaybird Mining Co. v. Weir, 271 U. S. 609.
Farmers & Merchants Savings Bank v. Minnesota, 232 U. S. 516.
Johnson v. Maryland, 254 U. S. 51, 56.

It is elemental, and now definitely decided by this Court, that the Federal government in all its activities is independent of state control. No Federal agency or instrumentalities, without Congressional consent, can be taxed by state authority. The instruments as was said by this Court, as early as in McCullough v. Maryland, include the mail, the mint, patent-rights, custom house papers, and judicial process among others. A patent right is authorized by Congress under Section 8 of Article 1 of the Constitutions * * * "to promote the progress of science and useful arts * * * ".

McCullough v. Maryland, 4 Wheat. 316, 432.
Jaybird Mining Co. v. Weir, 271 U. S., 609, 613.
Farmers & Merchants Bank of Minnesota, supra.

The petitioner in his brief relies upon such cases as

Hump Hairpin Co. v. Emmerson, 258 U. S. 290.
Shaffer v. Carter, 252 U. S. 37.
U. S. Glue Company v. Oak Creek, 247 U. S. 321.

The principles of these cases have no application. In both *Hump Hairpin Co. v. Emmerson* and *U. S. Glue Company v. Oak Creek,* there was involved the question whether the tax act under consideration affected interstate commerce so directly and immediately as to amount to a genuine and substantial regulation or restraint upon it, or whether it affected it only incidently or remotely, so that the tax is not in reality a burden, although in form it may touch, and in fact distantly affect it. In *Shaffer v. Carter,* this Court held that the principle, that a state could tax the land but not the crop, the tree but not the fruit, the mine or well but not the product, the business but not the profit derived from it, was wholly inadmissible, and the income tax of Oklahoma was sustained on the intra-state income of the non-resident Shaffer because the state had jurisdiction to tax the source from which the income accrued.

The inquiry in these causes does not involve a tax on sale of an article manufactured under a patent nor an excise tax measured by property which includes patents.

Patterson v. Kentucky, 97 U. S. 501.
Webber v. Virginia, 103 U. S. 344.
People v. Campbell, 138 N. Y. 543.

Where there is an interference with a Federal instrumentality, "reasonableness" is not the test of the power of the State. There is an entire absence of power. A tax upon the lease or rental (income) of the patents is a tax upon the power to use them and could be used to destroy the power to use them. If the patentee can not use his patents, free of interference, of what benefit is his power to exclude others from the use.

See *Gillespie v. Oklahoma,* supra.
Opinion of the Justices, 193 Mass. 608, 609.

III. The petition alleges that it has been the practice to tax such incomes (to wit royalties) in States where taxes on income are levied. Neither the States nor the laws referred to are cited.

It is only necessary to call attention to the danger of such comparisons. As above stated, the so-called Massachusetts Income Tax Act is one of limited operation. For example, it does not attempt to assess the incomes of non-residents or all the incomes of residents, such as did the Oklahoma State law in *Shaffer v. Carter*, supra and *Gillespie v. Oklahoma*, supra, nor can it be construed or defined as a general income tax law like the Federal Revenue Acts.

Compare *Revenue Act of 1926, Section 213,*
General Laws of Massachusetts, Chapter 62,
Sections 1 and 5.

WHEREFORE your respondent submits that the petition for the two writs should be denied.

Respectfully submitted,
GEORGE I. ROCKWOOD,
By GAGE, HAMILTON, JUNE & WHITE,
THOMAS H. GAGE,
MERRILL S. JUNE.

JAN 9 1928
CHARLES ELMORE CROPLEY
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1927.

No. 201.

HENRY F. LONG, Commissioner of Corporations and Taxation of the Commonwealth of Massachusetts, Petitioner,

v.

GEORGE I. ROCKWOOD, Respondent.

OCTOBER TERM, 1927.

No. 202.

HENRY F. LONG, Commissioner of Corporations and Taxation of the Commonwealth of Massachusetts, Petitioner,

v.

GEORGE I. ROCKWOOD, Respondent.

BRIEF FOR RESPONDENT

THOMAS HOVEY GAGE,
MERRILL S. JUNE,
Counsel for Respondent.

INDEX.

	Page
Statement of the Cases	1
Reference to opinion of courts below	1, 2
Statement of jurisdictional grounds	2, 3, 4
Statement of facts with references to Record	4, 5
The Argument	5
The Constitution and the Law	7
Some Principles Involved and Their Historical Development	8
1. The operations of a patentee are those of a Federal agency and are exempt from state taxation, provided the exemption is limited to those operations which constitute a part of the Federal purposes or are necessary to the discharge of the Federal purposes	8
2. A patent is a privilege or franchise granted under the Federal Constitution and neither the patent nor the income therefrom can be made the subject of state taxation and the states have no power to impair the value of the grant by any taxation whatever	9
Federal Purposes	11
The Massachusetts Tax, and Its Practical Operation and Effect	15

Table of Cases Cited.

Alpha Portland Cement Co. v. Commonwealth, 268 U. S. 203	14
American Tobacco Co. v. Werchmeister, 207 U. S. 284, 291, 292	16
Baltic Mining Co. v. Massachusetts, 231 U. S. 68, 82	15
Belknap v. Schild, 161 U. S. 10, 16	12
Bethlehem Steel Co. v. U. S., 42 Ct. Cl. 365	12
Brickill v. New York, 7 Fed. 479	12
California v. Central Pacific R. R., 127 U. S. 1-45	14
Chicago, Rock Island & Pacific Ry. v. Perry, 259 U. S. 548, 551	4
Choctaw & Gulf R. R. v. Harrison, 235 U. S. 292	14
Day v. Collector, 11 Wall 113, 20 L. ed. 122	19
Davis v. Wechsler, 263 U. S. 22, 24	4
Dayton Goose Creek R. Co. v. U. S., 263 U. S. 456, 478	14
Des Moines National Bank v. Fairweather, 263 U. S. 103	13
Dobbins v. Commissioners, Erie County, 16 Pet. (U. S.), 435 10 L. ed. 1022	19
Dorchey v. Kansas, 264 U. S. 286, 290	16
Electric Manufacturing Co. v. Edison Electric Light Co., 61 Fed. 834, 837; 10 C. C. A., 106	8
Farmers & Merchants Savings Bank v. Minnesota, 232 U. S. 516	14
First National Bank v. Adams, 258 U. S. 362; 66 L. ed. 661	13

	Page
First National Bank v. Anderson, 269 U. S. 341, 346	4, 13
First National Bank v. California, 262 U. S. 366, 370	14
Galveston H. & S. A. R. Co. v. Texas, 210 U. S. 217	15
Gatewood v. North Carolina, 203 U. S. 531, 541	16
Gillespie v. Oklahoma, 257 U. S. 501	14, 19
Hart v. Tax Commissioner, 240 Mass. 37, 39	15
Heiner v. Colonial Trust Co. (—U. S. —; 72 L. ed. —)	14
Hump Hairpin Co. v. Emmerson, 258 U. S. 290	18
Indian Illuminating Oil Co. v. Oklahoma, 240 U. S. 522	14
Jaybird Mining Co. v. Weir, 271 U. S. 609	14
Johnson v. Maryland, 254 U. S. 51, 56	14
Kendall v. Winsor, 21 How. 322, 16 L. ed. 165	8
Kennedy v. Tax Commissioner, 256 Mass. 426	15
Leisy v. Harden, 135 U. S. 100	15
Long v. Rockwood, —U. S. — 71 L. ed. —Adv. Sheets, June 1, 1927	2,4,16
Maguire v. Tax Commissioner, 230 Mass. 503, 512	15
Maguire v. Trefry, 253 U. S. 12, 17	15
McArthur Brothers Co. v. Commonwealth, 197 Mass. 137, 138	6
McCullough v. Maryland, 4 Wheat. 316, 399, 430, 432	12, 17
Metcalf v. Mitchell, 269 U. S. U. S. 514, 521	19
Motion Picture Co. v. Universal Film Co., 243 U. S. 502	17
North Western Mutual Life Ins. Co. v. Wisconsin (—U. S. —: 72 L. ed. —)	14, 19
Ohio v. Thomas, 173 U. S. 276	14
Opinion of the Justices, 220 Mass. 613, 624, 625	15
Opinion of the Justices, 193 Mass. 605, 609, 610	17, 18
Owensboro Nat. Bank v. Owensboro, 173 U. S. 664, 669, 43 L. ed. 850, 852	13
Paterson v. Kentucky, 97 U. S. 501	17
Pennock v. Dialogue, 2 Pet. 1, 7 L. ed. 327	8
Pollock v. Farmers Loan & Trust Co., 157 U. S. 429, 581, 158 U. S. 601, 637	16, 19
Railroad Co. v. Peniston, 18 Wall. 5	19
Raymer v. Tax Commissioner, 239 Mass. 410, 411	5, 6
Rubber Tire Wheel Co. v. Milwaukee Rubber Works Co., 154 Fed. 358; 83 C. C. A. 336	8
Shaffer v. Carter, 252 U. S. 37	20
Simpson v. Shepard, 230 U. S. 352	15
Standard Sanitary Mfg. Co. v. U. S. 226, U. S. 20	17
Strauss v. American Pub. Assoc. 231 U. S. 222	17
Tax Commissioner v. Putnam, 227 Mass. 522, 531	15
Telegraph Co. v. Texas, 105 U. S. 460	14
Underwood Typewriter Co. v. Chamberlain, 254 U. S. 113	18
U. S. Glue Co. v. Oak Creek, 247 U. S. 321	18
U. S. Shoe Machinery Co. v. U. S., 258 U. S. 451, 463	18

Page

Ward v. Love County, 253 U. S. 17, 22 4
Webber v. Virginia, 103 U. S. 344 17
Western Union Telegraph Co. v. Kansas, 216 U. S. 1 15

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Massachusetts, General Laws, Chap. 62 ..... 2, 5, 22
Massachusetts, General Laws, Chapter 211 ..... 6, 21
Massachusetts, Revised Laws, Chapter 12 23
Massachusetts, Acts of 1784, Chapter 17 9
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U. S. Acts of July 8, 1870, Chapter 230, Section 22 8
U. S., I. Stat. 109 Chapter 7, Section 1 10
U. S. Acts June 25, 1910, Chapter 423 12
U. S. Acts July 1, 1918, Chapter 114 12
U. S. Code, Title 35, Section 40 8
U. S. Code, Title 35, Section 68 12
U. S. Compiled Statutes, 1916, Section 9428 8
U. S. Compiled Statutes, 1916, Section 9465 12
U. S. Constitution, Article 1, Section 8 ..... 7, 16
U. S. Judicial Code, Section 237, as amended by Act of Congress Feb. 13, 1925 3
U. S. Revised Statutes, Section 4884 8

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Cooley on Taxation, Vol. 11 (4th Ed.) Section 618 and notes 17
Gray, Limitations on Taxing Power, pp. 393–396 17
Journal, 550, 561 10
Madison Papers, Vol. V, Supplement to Elliot's Debates, pp. 440, 511, 512, 561 10
Watson on Constitution, Vol. 1, pp. 659, 660 (1910) 10
Appendix 21–24

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1927.

No. 201.

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION, PETITIONER,

v.

GEORGE I. ROCKWOOD, RESPONDENT.

OCTOBER TERM, 1927.

No. 202.

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION, PETITIONER,

v.

GEORGE I. ROCKWOOD, RESPONDENT.

BRIEF FOR RESPONDENT

References

In these two cases, Writs of Certiorari to the Superior Court of the Commonwealth of Massachusetts for the County of Worcester are requested of this Court by the petitioner, Henry F. Long, Commissioner of Corporations and Taxation of said Commonwealth. The final

orders of the Superior Court appear in the Record (R. 39, 40). The rescripts or orders of the Supreme Judicial Court of said Commonwealth, with the statement of the grounds and reasons appear in the Record (R. 35, 36, 37) and are reported in Massachusetts Advance Sheets, 1926, page 2135 (to be reported in 257 Mass. 572).

Statement of Jurisdictional Grounds

The decisions sought to be reviewed were in two proceedings originally brought in the Superior Court of the Commonwealth for the County of Worcester by complainant (respondent herein) as a taxpayer under the provisions of Chapter 62 of the General Laws of Massachusetts, as amended, entitled "Taxation of Incomes," with a sub-title "Taxation of Income from Annuities, Professions, Employments, Trade and Business" (R. 3, 17). (See also Appendix.)

The complainant, a resident of Massachusetts, in his two complaints alleged several contentions (R. 5, 19). In each complaint was alleged

> "the patents granted * * * and the royalties therefrom received by complainant * * * are not taxable under said Chapter 62 (as amended) and there was error to include said royalties as subject to tax."

Also, in each complaint was alleged

> "the ownership of said patents and receipt of royalties * * * under the facts did not constitute income derived 'from professions, employments, trade or business' as defined under

said Chapter 62 (as amended) and there was error to include royalties as subject to tax.',

The Superior Court in the first case found and ruled "* * * that the income from royalties was not income from business, and not being income from any kinds of 'intangible personal property' specified in the income tax law, was not taxable" (R. 30). A similar finding and ruling was made in the second case (R. 31). Because of these rulings and of the failure to rule the cases were taken by said Commissioner on exceptions before the full court of the Supreme Judicial Court of the Commonwealth of Massachusetts (R. 1–3, 15–17) and that court in its rescript or order overruled the exceptions and ordered the entry to that effect in the Superior Court (R. 35, 36). Thereafter on December 27, 1926, final orders were entered in the Superior Court, granting the abatements (R. 39, 40). In its statement of the grounds and reasons for its decision, it appears that the Supreme Judicial Court considered that the decisive question involved in the two complaints was "the right of the Commonwealth to tax the income received from royalties for the use of patents issued by the United States." (R. 36.)

The present proceedings are brought under the provisions of the Judicial Code, Section 237, as amended by the Act of Congress of February 13, 1925.

The petitioner claims that (a) Superior Court's failure to rule on a Federal question (R. 30), the Supreme Court's decision (R. 35, 36) and the Superior Court's final orders thereafter (R. 39, 40) raise Federal questions reviewable herein.

In these cases petitions for certiorari were considered by this Court at the October 1926 Term and review was

granted, under said provisions of the Judicial Code and Rule 35 of this Court.

Long v. Rockwood (*two cases*) (—U. S.—71 L. ed.—) Adv. Sheets, June 1, 1927.

On the question of jurisdiction reference is made to the following cases:—

First National Bank v. Anderson, 269 U. S. 341, 346.
Davis v. Wechsler, 263 U. S. 22, 24.
Chicago, Rock Island & Pacific Ry. v. Perry, 259 U. S. 548, 551.
Ward v. Love County, 253 U. S. 17, 22.

Concise Statement of Facts

Prior to year 1916 the respondent Rockwood had invented certain units of automatic sprinkler systems and had been granted patents thereon by the United States. During the years in question, and for some time prior thereto, the Rockwood Sprinkler Company, a Massachusetts corporation, of which respondent was one of the organizers, officers and stockholders, had by license or consent of respondent used the inventions in the manufacture and sale of the systems and had paid royalties to respondent, based upon units produced under the patents. No other person or corporation had the use of the patents or inventions. The Massachusetts Tax

Commissioner included these royalties with the salaries, fees, etc., of the respondent Rockwood and levied a tax thereon as on business income. The taxes on the royalties are the taxes complained of and abated by the state Courts. The Record in these cases sets forth in considerable detail the facts.

See *Report of Commissioner Norman* (R. 7–14, 21–28)
Findings and Rulings by Superior Court (R. 28–32).
Exhibits A, B, and C (R. 40, 33, 34).

Argument

The Petitioner: the nominal petitioner and appellant to this Court is the Commissioner of Corporations and Taxation of the Commonwealth of Massachusetts; the real party in interest is the Commonwealth.

George I. Rockwood, the respondent herein, filed his complaint under Section 47 of Chapter 62 of the General Laws of the Commonwealth of Massachusetts for the purpose of appealing from a refusal of the Tax Commissioner to abate an income tax, and this proceeding in substance and effect was against the Commonwealth.

Raymer v. Tax Commissioner, 239 Mass. 410, 411.

It appears, however, from the Record that the decision of State Court to be reviewed is that of the Superior Court granting the abatements, and not any decision of the Supreme Judicial Court. The Superior Court found and ruled that the royalties were not "business income" and, not being income from any kind of "intangible personal property" specified in the

income tax law of Massachusetts, were not taxable, and found it unnecessary to pass upon a second issue, namely, the right of the State to tax income received for the use of patents granted by the United States, or upon some other issues involved.

The case went up on exceptions to the Supreme Judicial Court which over-ruled all exceptions, and held that the State could not tax either the patent or the income derived from its use, and found it unnecessary to pass on the first issue, namely that it (the income) is not on the facts "business income" within the meaning of the Massachusetts law. Thereafter, following the procedure prescribed by Sections 5 and 8 of Chapter 211 of the General Laws (printed in the Appendix), there was entered in the Superior Court in each case the entry, viz: Exceptions overruled. (R. 35, 36.)

The final judgment or decree of the Superior Court is not in ordinary form and does not of itself recite the grounds upon which it is based. "The decision of the Court must conform to the terms of the statute because the Commonwealth as the sovereign power has the right to fix absolutely the terms on which it may be impleaded in its own courts, the form in which the decision of the court shall be expressed, and the method by which the adjudication of the court shall be satisfied." (R. 39, 30.)

Raymer v. Tax Commissioner, 239 Mass. 410, 411.
McArthur Brothers Co. v. Commonwealth, 197 Mass. 137, 138.

There is, therefore, in these cases, the questions (a) upon what grounds the state court decision is based

and (b) whether the final judgment of the state court involves a Federal question. The respondent herein, without admitting there is a Federal question or waiving his rights herein or his contentions in the state courts, concedes that it is a necessary element of the power of this Court, to review judgments of state courts in cases involving the application and enforcement of Federal laws, that it determine for itself whether there is a Federal question properly before it.

The Constitution and the Law

The Constitution of the United States provides:—

> "The congress shall have power * * * to promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries; * * * and to make all laws which shall be necessary and proper for carrying into execution the foregoing powers, and all other powers vested by this constitution in the government of the United States, or in any department or officer thereof." *Section 8, Art. 1.*

Congress, pursuant thereto, has prescribed in its enactments for many years, substantially, that "Every patent shall contain * * * a grant to the patentee, his heirs or assigns, for the term of seventeen years, of the exclusive right *to make, use, and vend the invention or discovery* throughout the United States, and the Territories thereof * * *" (italics ours). Patents are issued in the name of the United States.

Section 40, Title 35, U. S. C.
Sections 9428 (R. S. Sec. 4884) United States Compiled Statutes of 1916.
Act of July 8, 1870, Ch. 230, Sec. 22, 16 Stat. 201 Chapter 357, Sec. 5, 5 Stat. 117 (1836).

A patent is sui generis; is issued to stimulate inventive minds to produce things useful to the public by the promise of substantial rewards and the public is primarily benefited by publication of the invention and its private use and its surrender to public use after the term.

Pennock v. Dialogue, 2 Pet. 1; 7 L. ed. 327.
Kendall v. Winsor, 21 How. 322, 16 L. ed. 165.
Rubber Tire Wheel Co. v. Milwaukee Rubber Works Co., 154 Fed. 358, 83 C. C. A. 336.
Electric Mfg. Co. v. Edison Electric Lt. Co., 61 Fed. 834, 837, 10 C. C. A. 106.

Some Principles Involved and Their Historical Development

It becomes necessary and important in these cases; (a) to consider briefly the history of the Constitutional provisions and Federal laws pertaining to patents and (b) to see if the following principles can be sustained and applied to these cases:

(1) The operations of a patentee are those of a Federal agency and are exempt from state taxation, provided the exemption is limited to those operations which constitute a part of the

> Federal purpose or are necessary to the discharge of the Federal purposes.
>
> (2) A patent is a privilege or franchise granted under the Federal Constitution and neither the patent nor the income therefrom can be made the subject of state taxation and the states have no power to impair the value of the grant by any taxation whatever.

Patents had been granted by governmental authority prior to the Constitution. As early as 1641 the Legislature of the Massachusetts Bay Colony—then called the General Court—granted a patent to Samuel Winslow for a process for the manufacture of salt. The Commonwealth of Massachusetts as late as July 2, 1784, issued a patent by an act entitled "An Act, granting to Simon Willard the exclusive Privilege of making and vending Clock-Jacks for five years." (Acts of 1784, Chapter 17, May Session). Thomas Jefferson was an inventor and has been considered the "father of the Patent Office."

In the Constitutional Convention, Charles Pinckney August 18, 1787, proposed to the Committee of Detail "To grant patents for useful inventions." Mr. Madison submitted "To encourage by premiums and provisions, the advancement of useful knowledge and discoveries." Although said Committee did not report, on September 5, 1787, the Committee of Eleven reported the clause which appears in the Constitution.

> "5 * * * to promote the progress of science and useful arts, by securing for limited times to authors and inventors, the exclusive right to their respective writings and discoveries; * * *"

It was adopted unanimously and apparently without discussion.

Madison Papers, Vol. V. Supplement to Elliot's Debates, pp. 440, 511, 512, 561.
Journal 550, 561.
Watson on Constitution, Vol. 1, pp. 659, 660 (1910).

In his first inaugural address, President Washington urged encouragement of inventions and Congress responded April 10, 1790, by passing an act entitled "An act to promote the progress of useful arts" and granting "the sole and exclusive right and liberty of making, constructing, using and vending to others to be used, the said invention or discovery."

Watson on Constitution supra p. 661,
Ch. 7, Sec. 1, 1 Stat. 109.

It is not, therefore, too much to say that the framers of the Constitution were unanimous in taking from the States the right to issue patents and in declaring patents to be exclusively of federal concern. The recommendations contained in the first Presidential message by Washington and the immediate passage of the Act granting patents confirmed and established a policy which has never been questioned.

Although the Federal government is one of limited powers, within its sphere it is supreme. It may attach a greater importance to one power than to another, but with the least of them the States cannot interfere.

Under an express power Congress grants patents, and at the same time is silent as to the taxation thereof and as to interference therewith. The petitioner, a State tax commissioner, in fact the State itself, seeks here to justify a tax on and an interference with a franchise or privilege granted by Congress pursuant to said power and without the consent of Congress to such action.

Federal Purposes

It has been held that under powers implied from express powers Congress could incorporate a bank in one state, that the bank could establish a branch in another state, and that the second state could not tax the branch. It was argued by Pinckney for the bank "It is, then, a tax on the legislative faculty of the union, on the charter of the bank. It imposes a stamp duty upon the notes of the bank, and thus stops the very source of its circulation and life. It is as much a direct interference with the legislative faculty of Congress as would be a tax on patents, or copyrights, or custom house papers, or judicial proceedings." (p. 399.) And Chief Justice Marshall in his decision added "If the states may tax one instrument, employed by the government in the execution of its powers, they may tax any and every other instrument. They may tax the mail; they may tax the mint; they may tax patent rights; they may tax the papers of the custom house; they may tax judicial process; they may tax all the means employed by the Government, to an excess which would defeat all the ends of government. This was not intended by the American people. They did not design to make their Government dependent on the States (p. 432). We find, then, on just theory, a total failure of this original right to tax

the means employed by the government of the Union, for the execution of its powers. The right never existed and the question whether it has been surrendered cannot arise (p. 430).

McCullough v. Maryland, 4 Wheat. 316, 399, 430, 432.

The Federal Government, itself, cannot now make use of a patented invention without the license of the inventor or making him compensation therefor.

Section 68, Title 35 U. S. C.
Section 9465 United States Compiled Statutes, 36 Stat. 851.
Act of June 25, 1910 C. 423.
Act of July 1, 1918 C. 114, 40 Stat. 705.

The Federal Government, and its officers, and cities in their corporate capacity, are liable for infringement of patents.

Brickill v. New York, 7 Fed. 479.
Belknap v. Schild, 161 U. S. 10, 16.
Bethlehem Steel Co. v. U. S., 42 Ct. Cl. 365.

"It is settled that the relation of the national banks to the United States, and the purposes intended to be subserved by their creation, are such that there can be no taxation, by or under state authority, of the banks, their property, or the shares of their capital stock other-

wise than in conformity with the terms and restrictions embodied in the assent given by Congress to such taxation."

Des Moines National Bank v. Fairweather, 263 U. S. 103.
First National Bank v. Anderson, 269 U. S. 341, 347.
Owensboro Nat. Bank v. Owensboro, 173 U. S. 664, 669; 43 L. ed. 850, 852.
First National Bank v. Adams, 258 U. S. 362; 66 L. ed. 661.

"To promote the progress of science and useful arts" by grant of letters patent is just as much a Federal or governmental purpose as to establish and maintain the business of national banks;—as to aid or promote the welfare and education of certain Indian Tribes on restricted lands, the principal and income of their property being exempt from State taxation;—as to promote the prosperity and welfare of the whole people of the United States through organization of territories (afterwards to become states), their various territorial (not State) municipal bonds and income therefrom being exempt from State taxation;—to maintain an old soldier's home, the governor thereof being exempt from state interference with his administration;—as to exempt from State taxation on operations such Federal agencies as railroads and telegraph companies—and to exempt the driver of a mail truck from local or state driving requirements.

First National Bank v. California, 262 U. S. 366, 370.
Jaybird Mining Co. v. Weir, 271 U. S. 609.
Gillespie v. Oklahoma, 257 U. S. 501.
Choctaw & Gulf R. R. v. Harrison, 235 U. S. 292.
Indian Oil Co. v. Oklahoma, 240 U. S. 522.
Farmers & Merchants Savings Bank v. Minnesota, 232 U. S. 516.
Ohio v. Thomas, 173 U. S. 276.
Johnson v. Maryland, 254 U. S. 51, 56.
Telegraph Co. v. Texas, 105 U. S. 460.
California v. Central Pacific R. R., 127 U. S. 1, 45.
Heiner v. Colonial Trust Co. (—U. S.—; 72 L. ed.—).

Also

Northwestern Mutual Life Ins. Co. v. Wisconsin (—U. S.—: 72 L. ed.—).

"to regulate interstate commerce" is also a Federal or governmental purpose under Section 8 and the states by their taxes may not burden interstate commerce, *and the forms of state regulations prohibited include efforts to tax the carrying on of such commerce and the attempted levies of taxes upon the receipts of interstate commerce as such; nor are we dealing with a franchise or an excise tax and the principles pertaining thereto.*

Alpha Portland Cement Co. v. Commonwealth, 268 U. S. 203.
Dayton-Goose Creek R. Co. v. U. S., 263 U. S. 455, 478.

Baltic Mining Co. v. Massachusetts, 231 U. S. 68, 82.
Galveston, H. & S. A. R. Co. v. Texas, 210 U. S. 217.
Western Union Telegraph Co. v. Kansas, 216 U. S. 1.
Simpson v. Shepard, 230 U. S. 352.
Leisy v. Harden, 135 U. S. 100.

The Massachusetts Tax, and Its Practical Operation and Effect

The Massachusetts tax law here in question levies a tax upon the income of property and is in reality a tax upon the property itself. The courts of the state have so construed the law, as levying a tax upon property and not a personal tax nor an excise tax. It is not a general income tax, but one of limited operation on income from certain sources only. Massachusetts had taxed business incomes as property for a century, but not royalties as such.

Opinion of the Justices, 220 Mass. 613, 624, 625.
Tax Commissioner v. Putnam, 227 Mass. 522, 531.
Maguire v. Tax Commissioner, 230 Mass. 503, 512.
Hart v. Tax Commissioner, 240 Mass. 37, 39.
Kennedy v. Tax Commissioner, 256 Mass. 426.

See *Maguire v. Trefry*, 253 U. S. 12, 17.

Also: Historical sketch of Massachusetts tax on "incomes" in brief of Counsel, *Pollock* case, 158 U. S. at 607–617. and Revised Laws of Massachusetts, Chapter 12 in Appendix.

The Supreme Judicial Court of the State in these cases held that the tax levied was in effect a tax on the patent itself and the tax levied was a property tax. And this Court has previously held that a tax on the rent from real estate was in effect a tax on the land itself and that a tax on income derived from invested personal property was a tax on the personal property itself. Property in a patent, like property in a copyright, is the creation of the Federal statutes passed in the exercise of the power vested by the Federal Constitution in Art. 1, Section 8.

Rockwood v. Commissioner, supra.
Pollock v. Farmers Loan & Trust Co., 157 U. S. 429, 581.
158 U. S. 601, 637.

See *American Tobacco Co. v. Werckmeister*, 207 U. S. 291, 292 and cases cited.

This Court will not review the decision of the highest court of a state as to the scope, construction and nature of a local statute.

Gatewood v. North Caroline, 203 U. S. 531, 541.
Dorchey v. Kansas, 264 U. S. 286, 290.

It seems settled that patents themselves issued by the United States or the privilege or franchise granted by the United States cannot be taxed or interfered with by the States without the consent of Congress which consent has not been granted. This was even conceded

by the petitioner (respondent below) as stated in the opinion of the Supreme Judicial Court (R. 37). Apparently those state courts as have considered the subject have so held.

McCullough v. Maryland, 4 Wheat. 316, 432.
Opinion of the Justices, 193 Mass. 605, 609, 610.
Cooley on Taxation, Vol. 2 (4th Ed.) Sec. 618 and notes.
Cooley on Constitutional Limitations, 590 (6 Ed.).
Gray, Limitations on Taxing Power, pp. 393–396

We are concerned here with the patentee's property right, with his granting to another the use of the rights or privileges conferred by his patent;—with his enjoyment of the right in the discovery;—with "the exclusive right to make, use and vend the invention or discovery" as the Statute describes it, and this would seem to be secured and protected by national authority against all interference, *and we are not concerned with "the use of the tangible property which comes into existence by the application of the discovery", nor with such use as violates anti-trust laws nor such use as comes into conflict with police powers,* which uses may not be beyond the control or regulation of State or Federal legislation. The distinction is clear. (Italics ours).

Patterson v. Kentucky, 97 U. S. 501.
Webber v. Virginia, 103 U. S. 344.
Standard Sanitary Mfg. Co. v. U. S., 226 U. S. 20.
Straus v. American Publ. Assoc., 231 U. S. 222.
Motion Picture Co. v. Universal Film Co., 243 U. S. 502.

U. S. Shoe Machinery Co. v. U. S., 258 U. S. 451, 463.
Opinion of the Justices, 193 Mass. 605.

A patentee is acting under a special grant to promote constitutional purposes, has the support of Congressional action, and there can be no interference with the exercise of that power. After the tangible property, the fruit of the discovery, comes into being, then the product may become subject to local taxation and, if and when put into interstate commerce, the principles of the cases relating thereto then become applicable.

United States Glue Co. v. Oak Creek, 247 U. S. 321.
Hump Hairpin Co. v. Emmerson, 258 U. S. 290.
Underwood Typewriter Co. v. Chamberlain, 254 U. S. 113.

Where a state attempts to tax income, inquiry is allowed into the sources from which the income is derived and the same considerations that invalidate a tax upon the sources invalidate a tax upon the income. A tax laid upon the income (royalties or use of patents) would burden the exempted source and defeat or impair the Federal purposes by preventing, handicapping or destroying the use of the patent right granted by the United States. "Reasonableness" is not the test. There is an entire absence of power. A tax upon the lease or rental (income) of the patents, derived by the grant to another of the use of the rights or privileges conferred by the patent, is a tax upon the power or right to use them and such tax could be employed to burden or

destroy the power to use them. If the patentee cannot use his patent rights, free of interference, of what benefit is his power also to exclude others from the use.

Gillespie v. Oklahoma, supra, p. 505.
Pollock v. Farmers Loan & Trust Co., supra.
Northwestern Mutual Life Ins. Co. v. Wisconsin, (—U. S.—; 72 L. ed.—).
Railroad v. Peniston, 18 Wall. 5.

It may be contended that here is a source of income which ought to bear its share of the burdens of Government, State as well as Federal; but tax laws are not to be applied under any general theory of theoretical equalization, but only pursuant to the necessary and inevitable consequence of actual legislation.

The salaries of the Federal Judiciary in Massachusetts, the Customs House and Navy Yard employees, and Internal Revenue officers cannot be taxed by the Commonwealth of Massachusetts. Neither can the income received from bonds of the Federal Government or issued under its authority and to promote its Federal purposes. The Federal government is similarly restricted. The fact that these incomes cannot be taxed by the Commonwealth as received by its resident citizens necessarily means that other residents have to bear an increased burden of taxation.

Metcalf v. Mitchell, 269 U. S. 514, 521.
Dobbins v. Commissioners, Erie County, 16 Pet. (U. S.) 435; 10 L. ed. 1022.
Day v. Collector, 11 Wall 113; 20 L. ed. 122.

The Legislature must determine the incidents of taxation and where and when and how this burden shall be

apportioned. If Congress should determine that the income from royalties for the use of patents and copyrights should be taxable by the States it is anticipated that restrictions will be imposed to prevent the destruction of the privilege secured by the patent or copyright. In this case the Commonwealth of Massachusetts attempts to tax all the royalties received from the use of the United States patent because the patentee happens to be a resident of Massachusetts. It might also attempt a tax on the patent. If the patentee issues a license to a resident of New York in return for royalties to be paid, the States of New York might contend that the patentee is deriving income in New York and levy an income tax on the patentee on account of the royalties therein paid by the New York licensee. Oklahoma might do likewise. Ohio might attempt to impose an excise tax upon the privilege of licensing an Ohio resident for use of patent.

See *Shaffer v. Carter*, 252 U. S. 37.

Congress has expressly consented to state taxation of national banks but has imposed limitations in order to protect the banks and the holders of their shares from undue taxation. But Congress may conclude, and perhaps by its silence on the subject has concluded, to reserve to itself this particular field of tax revenue.

In fine, unless the patentee's right to the patent and to the income from his patent is secure against State taxation it is conceivable that the patent would have little if any value.

Respectfully submitted,

THOMAS HOVEY GAGE,
MERRILL S. JUNE,
Counsel for Respondent.

APPENDIX

EXTRACTS FROM CHAPTER 211 OF THE GENERAL LAWS OF MASSACHUSETTS

"SECTION 3. The supreme judicial court shall have general superintendence of all courts of inferior jurisdiction to correct and prevent errors and abuses therein if no other remedy is expressly provided; and it may issue writs of error, certiorari, mandamus, prohibition, quo warranto and all other writs and processes to such courts and to corporations and individuals which may be necessary to the furtherance of justice and to the regular execution of the laws."

"SECTION 5. Questions of law arising upon exceptions or report, upon appeals from the superior court, upon cases stated or upon special verdicts and all issues in law, except as otherwise provided, shall be heard and determined by the full court."

"SECTION 8. The full court shall, as soon as may be after the decision of the questions submitted to it, make and enter a proper order, direction, judgment or decree for the further disposition of the case, or cause a rescript, containing a brief statement of the grounds and reasons of the decision, to be filed therein; or it may by a writ of certiorari or other proper process remove the record of the case, or order it to be removed, into the supreme judicial court, there enter judgment, and remand the record to the court from which it was removed to carry such judgment into effect, or instead thereof, the full court may order a new trial or further proceedings at the bar of the supreme judicial court, or order sentence to be awarded or execution issued in said court."

"SECTION 9. The records and rescripts which are made after the decision of questions of law shall contain a brief statement of the reasons therefor; and if no further opinion is written within sixty days, the reporter shall publish the case with the opinion contained in such record or rescript."

Extracts from General Laws of Massachusetts, Chapter 62, as Amended

"TAXATION OF INCOME FROM ANNUITIES, PROFESSIONS, EMPLOYMENTS, TRADE AND BUSINESS

SECTION 5. Income of the following classes received by any inhabitant of the commonwealth during the preceding calendar year shall be taxed as follows:"

(a) . . .

"(b) The excess over two thousand dollars of the income, as defined in section six, derived from professions, employments, trade or business shall be taxed at the rate of one and one-half per cent per annum. In determining such income the rental value of living quarters furnished any individual as part of his compensation shall be included. The wages and salaries of employees and officers of the United States government shall not be taxed. Retirement allowances, however, described, from the commonwealth or any county, city, town or district thereof, or from any person if not exempt by law, and interest received in the course of business by persons subject to the provisions of sections seventy to eighty-five, inclusive, of chapter one hundred and forty, shall be taxed under this sub-section."

(c) . . .

"SECTION 6. Income taxable under subsection (b) of section five shall be the gross income from the profession, employment, trade or business, in the year for which the income is computed, not including income exempt from taxation under this chapter or taxable hereunder otherwise than under said subsection (b), but including gains from the sale of capital assets, other than intangible personal property, employed therein; less the following deductions:"

"(a) Expenses paid within the year in the profession, employment, trade or business, including the cost of ordinary repairs but not including personal or family expenses; provided, that premiums paid for use and occupancy insurance, or rent insurance, shall not be deducted as part of such expenses."

Extracts from Chapter 12 of the Revised Laws of Massachusetts

"SECTION 1. A poll tax of two dollars shall be assessed on every male inhabitant of the commonwealth above the age of twenty years, whether a citizen of the United States or an alien."

"SECTION 2. . . .

"SECTION 3. . . .

"SECTION 4. Personal estate for the purpose of taxation shall include:—

First, . . .

Second, . . .

Third, . . .

Fourth, The income from an annuity, or from ships and vessels engaged in the foreign carrying trade within the meaning of section seven, and the excess above two thousand dollars of the income from a profession, trade or employment accruing to the person to be taxed during the year ending on the first day of May of the year in which the tax is assessed. Incomes derived from property subject to taxation shall not be taxed."

SUPREME COURT OF THE UNITED STATES.

Nos. 201-202.—October Term, 1927.

Henry F. Long, Commissioner of Corporations and Taxation of the Commonwealth of Massachusetts, Petitioner,
201 *vs.*
George I. Rockwood.

Henry F. Long, Commissioner of Corporations and Taxation of the Commonwealth of Massachusetts, Petitioner,
202 *vs.*
George I. Rockwood.

On Writs of Certiorari to the Superior Court for the County of Worcester, State of Massachusetts.

[May 14, 1928.]

Mr. Justice McReynolds delivered the opinion of the Court.

These causes present the question whether the State of Massachusetts may tax, as income, royalties received by one of her citizens for the use of patents issued to him by the United States. The Supreme Judicial Court of that State held such an imposition would amount to a tax upon the patent right itself and was prohibited by the Federal Constitution. We agree with that conclusion.

The Constitution (Art. 1, Sec. 8) empowers Congress "to promote the progress of science and useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries; . . ." The first Congress provided for issuance, in the name of the United States, of letters patent granting "for any term not exceeding fourteen years, the sole and exclusive right and liberty of making, constructing, using and vending to others to be used, the said invention or discovery . . ." Act April 10, 1790, Sec. 1, Chap. 7, 1st Stat. 110.

Chap. 230, Act July 8, 1870, 16 Stat. 201 (Rev. Stat. Sec. 4884; Sec. 40, Title 35, U. S. Code)—

> Sec. 22. And be it further enacted, That every patent shall contain a short title or description of the invention or discov-

ery, correctly indicating its nature and design, and a grant to the patentee, his heirs or assigns, for the term of seventeen years, of the exclusive right to make, use and vend the said invention or discovery throughout the United States and the Territories thereof, . . .

Chief Justice Marshall, speaking for the court in *Grant* v. *Raymond*, 6 Pet. 220, 241-242, stated the general purpose for which patents issue—

> To promote the progress of useful arts, is the interest and policy of every enlightened government. . . . This subject was among the first which followed the organization of our government. It was taken up by the first congress . . . The emendatory act of 1793 contains the same language, and it cannot be doubted that the settled purpose of the United States has ever been, and continues to be, to confer on the authors of useful inventions an exclusive right in their inventions for the time mentioned in their patent. It is the reward stipulated for the advantages derived by the public for the exertions of the individual, and is intended as a stimulus to those exertions. The laws which are passed to give effect to this purpose ought, we think, to be construed in the spirit in which they have been made . . . The public yields nothing which it has not agreed to yield; it receives all which it has contracted to receive. . . .

Kendall v. *Winsor*, 21 How. 322, 327-328—

> It is undeniably true, that the limited and temporary monopoly granted to inventors was never designed for their exclusive profit or advantage; the benefit to the public or community at large was another and doubtless the primary object in granting and securing that monopoly.

Bloomer v. *McQuewan*, 14 How. 539, 549—

> The franchise which the patent grants, consists altogether in the right to exclude every one from making, using, or vending the thing patented, without the permission of the patentee. This is all he obtains by the patent.

See also *Paper Bag Patent* case, 210 U. S. 405, 423; *Bauer* v. *O'Donnell*, 229 U. S. 1, 11.

The power to exclude others granted by the United States to the patentee subserves a definite public purpose—to promote the

progress of science and useful arts. The patent is the instrument by which that end is to be accomplished. It affords protection during the specified period in consideration of benefits conferred by the inventor. And the settled doctrine is that such instrumentalities may not be taxed by the States.

In *California* v. *Pacific Railroad Co.*, 127 U. S. 1, the State sought to sustain a tax laid upon a franchise granted by the United States; but its power therein was denied. Through Mr. Justice Bradley this court said—"Recollecting the fundamental principle that the Constitution, laws and treaties of the United States are the supreme law of the land, it seems to us almost absurd to contend that a power given to a person or corporation by the United States may be subjected to taxation by a State." The same general doctrine was approved by *McCullough* v. *Maryland*, 4 Wheaton, 316; *Home Savings Bank* v. *Des Moines*, 205 U. S. 503; *Farmers, etc. Bank* v. *Minnesota*, 232 U. S. 516; *Choctaw & Gulf R. R. Co.* v. *Harrison*, 235 U. S. 292; *Indian Terr., etc. Oil Co.* v. *Oklahoma*, 240 U. S. 522; *Smith* v. *Kansas City Title & Trust Co.*, 255 U. S. 180; *Gillespie* v. *Oklahoma*, 257 U. S. 501; *Clallam County* v. *United States*, 263 U. S. 341; *First National Bank* v. *Anderson*, 269 U. S. 341; *Jaybird Mining Co.* v. *Weir*, 271 U. S. 609; *Northwestern Mutual Life Ins. Co.* v. *Wisconsin* (November 21, 1927).

The courts of last resort in Pennsylvania and New York have held that a state may not tax patents granted by the United States. *Westinghouse Elec. Mfg. Co.* v. *Commonwealth*, 151 Pa. 265; *People, etc.* v. *Assessors*, 156 N. Y. 417. And no opinion to the contrary has been cited.

As United States patents grant only the right to exclude, our conclusion is not in conflict with those cases which sustain the power of the States to exercise control over articles manufactured by patentees, to regulate the assignment of patent rights, and to prevent fraud in connection therewith. *Patterson* v. *Kentucky*, 97 U. S. 501; *Webber* v. *Virginia*, 103 U. S. 344; *Allen* v. *Riley*, 203 U. S. 347; *John Woods & Sons Co.* v. *Carl*, 203 U. S. 358; *Ozan Lumber Co.* v. *Union County National Bank*, 207 U. S. 251.

The challenged judgments are affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

SUPREME COURT OF THE UNITED STATES.

Nos. 201 and 202.—October Term, 1927.

Henry F. Long, Commissioner of Corporations and Taxation of the Commonwealth of Massachusetts, Petitioner,
201 *vs.*
George I. Rockwood.

Same,
202 *vs.*
Same.

On Writs of Certiorari to the Superior Court for the County of Worcester, State of Massachusetts.

[May 14, 1928.]

Mr. Justice Holmes.

These are complaints brought by the respondent against the Commissioner of Corporations and Taxation of Massachusetts for the abatement of income taxes for the years 1921 and 1922. The question raised as stated by the Supreme Judicial Court of the State is whether the Commonwealth has the right to tax the income received from royalties for the use of patents issued by the United States. That Court held that the Commonwealth had no such right under the Constitution of the United States and the Commissioner obtained a writ of certiorari from this Court.

The reasoning of the Court is simple. If the State 'cannot tax the patent, it cannot tax the royalties received from its use'. The postulate is founded on the casual intimation of Chief Justice Marshall in *McCulloch* v. *Maryland*, 4 Wheat. 316, 432, and is said to have been conceded below by the Commissioner. It hardly is conceded here and whether it is or is not if this Court should be of opinion that the conclusion urged by the Commissioner can be supported upon broader grounds than he felt at liberty to take the Court is not estopped by his doubts. Why then cannot a State tax a patent by a tax that in no way discriminates against it? Obviously it is not true that patents are instrumentalities of the Gov-

ernment. They are used by the patentees for their private advantage alone. If the Government uses them it must pay like other people. *Richmond Screw Anchor Co.* v. *United States,* Jan. 3, 1928. The use made by the patentee may be not to make and sell the patented article but simply to keep other people from doing so in aid of some collateral interest of his own. *Continental Paper Bag Co.* v. *Eastern Paper Bag Co.,* 210 U. S. 405, 422, 424. National banks really are instrumentalities of the Government and directly concern the national credit. Indians are wards of the nation. Interstate commerce is left expressly to regulation by Congress and the States can intermeddle only by its consent. In this case the advantages expected by the Government are mainly the benefits to the public when the patent has expired and secondarily the encouragement of invention, *Pennock* v. *Dialogue,* 2 Peters, 1, 19. The most that can be said is that a tax is a discouragement so far as it goes and to that extent in its immediate operation runs counter to the Government intent. But patents would be valueless to their owner without the organized societies constituted by the States, and the question is why patents should not contribute as other property does to maintaining that without which they would be of little use.

Most powers conceivably may be exercised beyond the limits allowed by the law. Rights that even seem absolute have these qualifications. *American Bank & Trust Co.* v. *Federal Reserve Bank of Atlanta,* 256 U. S. 350, 358. But we do not on that account resort to the blunt expedient of taking away altogether the power or the right. *Board of Trade* v. *Christie Grain & Stock Co.,* 198 U. S. 236, 247, 248. The power to tax is said to be the power to destroy. But, to repeat what I just now have had occasion to say in another case, this Court, which so often has defeated the attempt to tax in certain ways, can defeat an attempt to discriminate or otherwise to go too far without wholly abolishing the power to tax. The power to fix rates is the power to destroy, but this Court while it endeavors to prevent confiscation does not prevent the fixing of rates. Even with regard to patents some laws of a kind that might destroy the use of them within the State have been upheld. *Patterson* v. *Kentucky,* 97 U. S. 501. *Webber* v. *Virginia,* 103 U. S. 344. *Emert* v. *Missouri,* 156 U. S. 296. They must be reasonable or they will be held void, but if this Court deems them reasonable they stand. *Allen* v. *Riley,* 203 U. S. 347, 355.

om a grant by the United
The fact that the franchise came fr, standing by itself, than
States is no more reason for exemptio land from the same source.
is the derivation of the title to a lot of *Baltimore Shipbuilding &*
Tucker v. *Ferguson*, 22 Wall. 527. In 75, the land was conveyed
Dry Dock Co. v. *Baltimore*, 195 U. S. ould be built upon it which
subject to a condition that a dry-dock sh t to use free from charge
the United States was to have the righ o the United States on a
for docking and which was to revert on the dry-dock being unfit
diversion of the land to any other use or in which the United States
for use for six months. Certainly a case n an ordinary patent. Yet
was much more clearly interested than i any nor the land was an
there it was held that neither the com d that there was nothing
instrumentality of the United States a . See further *Forbes* v.
to hinder the right of the State to ta
Gracey, 94 U. S. 762.

THERLAND and Mr. Justice
Mr. Justice BRANDEIS, Mr. Justice SU
STONE agree with this opinion.